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No. _____

In The

Supreme Court of the United States

October Term, 1992

NATIONAL UNION FIRE INSURANCE COMPANY
OF PITTSBURGH, PA.

Petitioner,

vs.

JOHN B. CAMP, TRUSTEE,
SECURITIES INVESTOR PROTECTION CORPORATION,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

GUY W. HARRISON
Counsel of Record

CARL K. HOFFMANN
JAMES F. CROWDER, JR.

KIMBRELL & HAMANN, P.A.
Suite 900 Brickell Centre
799 Brickell Plaza
Miami, Florida 33131
305-358-8181

Attorneys for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. WHETHER CASE AND STATUTORY LAW PERMITS A TRUSTEE, IN A STOCKBROKER LIQUIDATION PROCEEDING COMMENCED BY THE SECURITIES INVESTOR PROTECTION CORPORATION ("SIPC") PURSUANT TO THE SECURITIES INVESTOR PROTECTION ACT, 15 U.S.C. § 78aaa, et. seq. ("SIPA"), TO SELECTIVELY INVALIDATE PROVISIONS OF A FIDELITY BOND WHICH SIPC HAS APPROVED AND WHICH SIPA REQUIRES ALL SIPC MEMBERS TO CARRY.

2. WHETHER SIPA § 78fff(b) PERMITS THE "ANTI-IPSO-FACTO" PROVISION OF THE BANKRUPTCY CODE, 11 U.S.C. § 541(c)(1)(B), TO BE USED IN A SIPA STOCKBROKER LIQUIDATION PROCEEDING.

LIST OF INTERESTED PARTIES

Securities Investor Protection Corporation; Theodore H. Focht; Michael E. Don; Josephine Wang

John H. Camp, Jr., Trustee, Blackwell, Walker & Hoehl; Neal B. Shniderman

Carl K. Hoffmann; James F. Crowder, Jr.; Guy W. Harrison; Kimbrell & Hamann, P.A.

The Honorable A. Jay Cristol, U.S. Bankruptcy Judge (The Hon. Eugene Spellman, U.S. District Judge below, is deceased)

National Union Fire Insurance Company of Pittsburgh, PA. National Union is a wholly-owned subsidiary of American International Group. National Union does not have any non-wholly owned subsidiaries.

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REFERENCE TO LOWER COURT OPINIONS

1. In re Government Securities Corp., 972 F.2d 328 (11th Cir. 1992)
2. In re Government Securities Corp., 111 B.R. 1007 (S.D.Fla. 1990)
3. In re Government Securities Corp., 101 B.R. 343 (S.D.Fla. 1989)

STATEMENT OF JURISDICTION

This is a petition for review by Writ of Certiorari of a judgement of the United States Court of Appeals for the Eleventh Circuit entered on September 14, 1992. Jurisdiction is conferred upon this Court by 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED IN THE CASE

1. 11 U.S.C. § 541
2. 15 U.S.C. § 78fff
3. 15 U.S.C. § 78iii

Pursuant to Rule 14(f) of the Supreme Court Rules, these statutory provisions are included in the appendix.

STATEMENT OF THE CASE

National Union Fire Insurance Company of Pittsburgh, PA ("National Union") issued a standard form Securities Dealer Blanket Bond No. 959-9000 ("bond") to Government Securities Corp. ("GSC") on February 1, 1987, for the period February 1, 1987 to November 1, 1987. Section 12(c) of the bond provided for immediate termination of the bond upon takeover of the bonded securities institution, as follows:

> The bond shall be deemed terminated or cancelled as an entirety . . . immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials. . . .

Bond ¶12(c) (Exhibit "A" to Trustee's Amended Complaint served September 30, 1988).

On May 12, 1987, the Securities Investor Protection Corporation ("SIPC") filed an application in the District

Court for the Southern District of Florida seeking a protective decree adjudicating that the customers of GSC, a securities broker, were in need of protection under the Securities Investors Protection Act of 1970, as amended ("SIPA"), 15 U.S.C. §§ 78aaa, *et seq.* Federal court jurisdiction was founded upon 15 U.S.C. § 78eee(a)(3) and (b)(2). GSC consented to the entry of an order appointing a trustee for the liquidation of its business pursuant to SIPA. (R1-8, item 9).

That same day, United States District Judge Alcee L. Hastings entered an order commencing a liquidation proceeding for GSC under SIPA. (R1-8, item 10). At the request of SIPC, Judge Hastings appointed John R. Camp, Jr. as Trustee. The May 12th order removed the Title 15 liquidation proceeding to the bankruptcy court for the Southern District of Florida pursuant to 15 U.S.C. § 78eee(b)(4).

On June 2, 1987, the SIPA Trustee wrote a letter to National Union to inform it of a possible loss under the bond. (Tr.Exh. 1). The Trustee filed a proof of loss on December 7, 1987. (Bankruptcy Trial Transcript, at 55). On December 23, 1987. National Union denied coverage on the ground that the bond automatically terminated upon the May 12, 1987 filing of the Application for a Protective Decree and appointment of a SIPC trustee to liquidate GSC. R2-18-3.

On August 11, 1988, the Trustee filed an adversary action in the bankruptcy court against National Union seeking money damages for breach of the bond. (Trustee's Complaint). Thereafter, the Trustee amended its complaint to seek a judgement declaring the rights of the parties under the bond. (Trustee's Amended Complaint, served September 30, 1988).

On November 15, 1988, in an omnibus order, the bankruptcy court denied *inter alia* National Union's motion to dismiss and held that "relevant portions of the Bankruptcy Code which prevent an automatic termination or limitation of

the estate's property rights upon the filing of a bankruptcy proceeding or the appointment of a bankruptcy trustee are applicable in this adversary matter filed in a SIPA proceeding." On March 15, 1989, the bankruptcy court entered its Findings of Fact and Conclusions of Law and its Final Judgment. In its conclusions of law, the bankruptcy court readopted its November 15, 1988 holding with respect to the bond's termination clause. National Union timely filed its Notice of Appeal to the district court on March 27, 1989.

On March 16, 1990, the District Court entered an Order Affirming Bankruptcy Court in which he affirmed the bankruptcy court's holding that the termination-upon-takeover provision of the bond was invalid and void in Title 15 [SIPA] liquidation proceedings.

On September 14, 1992, the Eleventh Circuit issued its judgement affirming the bankruptcy court's and the District Court's decisions.

REASONS FOR GRANTING THE WRIT

POINT I

THE ELEVENTH CIRCUIT'S HOLDING THAT A GOVERNMENT INSURER-LIQUIDATOR MAY SELECTIVELY INVALIDATE PROVISIONS OF A STANDARD BOND WHICH THE GOVERNMENT INSURER HAS APPROVED AND WHICH APPLICABLE STATUTES REQUIRE INSURED ENTITIES TO CARRY DIRECTLY CONFLICTS WITH DECISIONS OF THE FIFTH, SIXTH AND NINTH CIRCUIT COURTS OF APPEAL ON THE SAME POINT OF LAW.

This case presents a straightforward question of law: may the government, having required a regulated company to carry a government-approved fidelity bond, selectively invalidate provisions of that bond which work to the government's disadvantage during liquidation proceedings? Three Circuit Courts of Appeal have answered this question with a resounding "no." *California Union Insurance Co. v. American Diversified Savings Bank,* 948 F.2d 556 (9th Cir. 1991); *FDIC v.*

Aetna Casualty and Surety Co., 903 F.2d 1073 (6th Cir. 1990); *Sharp v. FSLIC*, 858 F.2d 1042 (5th Cir. 1988).

Only the Eleventh Circuit, in the present case, has stated that such inconsistent conduct is acceptable. By so holding, the court rejected fundamental principles of law and fairness. The Eleventh Circuit's cursory analysis also did not address the factual similarities between the FDIC/FSLIC statutes and SIPA which compel the same result in the *Sharp* cases and in the present case. Both statutory schemes are identical in that they require industry members to carry fidelity bond insurance in the standard form negotiated between the industry members, the Surety Association of America, and the regulators themselves.

Sharp, *Aetna* and *California Union* all recognize that the government cannot repudiate during liquidation proceedings the very fidelity bonds which it has required pursuant to regulation. There is no factual or legal distinction between the present case and *Sharp*, *Aetna* and *California Union* which justifies the Eleventh Circuit's contrary and conflicting holding.

A. SIPA ESTABLISHES A SYSTEM OF INSURANCE FOR CUSTOMERS AND REGULATION OF ITS MEMBER FIRMS.

The primary purpose of SIPA is to provide insurance against customer loss. The financial stability and integrity of SIPC members is crucial to minimize insured losses, and SIPA does indeed provide for extensive regulation of the affairs of SIPC members. In fact, SIPA's requirement of member compliance with "applicable financial responsibility rules" is perhaps its most important aspect.

From the genesis of its legislative history through recent court decisions, SIPC has been referred to as an insurer and compared to other federal corporations charged with insuring particular segments of the financial economy. The legislative history of SIPA shows that SIPA was "enacted to provide to customers of security broker-dealers protection against losses which might occur as a result of the financial failure of

broker-dealers."[1] The "most striking feature of the SIPA is the insurance program, administered by the SIPC." **Note,** "The Securities Investor Protection Act of 1970: An Early Assessment," 73 Columbia Law Review 802, 803-804 (1973). This Court and lower federal courts have consistently recognized that the main purpose of SIPA is to protect members of the investing public against individual hardship, and to restore investor confidence. *Securities Investor Protection Corporation v. Barbour,* 421 U.S. 412 (1975); *In Re Stalvey & Associates, Inc. (Securities Investor Protection Corporation v. Wise),* 750 F.2d 464 (5th Cir. 1985); *In Re Securities and Exchange Commission v. White & Co., Inc.,* 546 F.2d 789 (8th Cir. 1976); *Securities and Exchange Commission v. Packer, Wilbur & Co., Inc.,* 498 F.2d 978 (2d Cir. 1974).

SIPC functions as an insurance company funded by contributions of its members for the purpose of protecting the investors. All persons registered as brokers or dealers under Section 15(b) of the 1935 Act [15 U.S.C. § 78o(b)] are required to be members of SIPC. 15 U.S.C. § 78ccc(a)(2). In the event that the SIPC insurance fund is deemed inadequate for the purposes of the Act, the Department of the Treasury is authorized to make loans to SIPC not to exceed $1 billion. 15 U.S.C. § 78ddd(h). As the Ninth Circuit Court of Appeals held in 1986, SIPC protects "the customers of securities brokers by *insuring* the net equity of customers' accounts up to specified maxima." *Securities Investor Protection Corporation v. Vigman,* 803 F.2d 1513, 1516 (9th Cir. 1986), citing *Touche Ross & Co. v. Redington,* 442 U.S. 560, 564-565 n.5 (1979) (emphasis supplied). Although the Ninth Circuit recognized that SIPC insurance had various limits on the amount of coverage, it is nevertheless an insurer. *Vigman,* 803 F.2d at 1516.[2]

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[1] *See* S. Report. No. 95-763, 95th Cong., 2d Sess. (1978), reported in 1978 U.S. Code Cong. and Adm. News 764.

[2] Protection is the general object and purpose of insurance by affording indemnity or security. *See* Couch on Insurance 2d. (Rev. Ed.) Section 1:2. Limiting coverage or the class of individuals who are protected in no way alters the fact that insurance is provided.

SIPA's purpose, however, is broader than simply having the government, through SIPC, pick up the pieces after a stockbroker fails. An essential part of SIPA's "insurance" function is to assure that SIPC members continue as viable, ongoing concerns. It is inconceivable that Congress would create a stockbroker customer insurance program, backed by a $1 billion federal line of credit, without taking some steps to require the insured institutions to comply with strict standards of operation.

SIPA takes this self-evident principle into account. The legislative history of SIPA confirms that a regulatory mechanism was one of the primary purposes of the Act:

> [SIPA] is intended to serve several purposes: to protect individual investors from financial hardship; to insulate the economy from the disruption which can follow the failure of major financial institutions; and to achieve a general *upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss.*

S. Rep. No. 1218, 91st Cong., 2d Sess. 4 (1970) (emphasis added). *See also* H.R. Rep. No. 91-1613, 91st Cong., 2d Sess. 1 (1970) (same language as that emphasized above).

SIPC itself was never intended to have direct regulatory powers. Given the extensive authority of the SEC and the longstanding regulatory practices of self-regulatory organizations ("SRO's") such as the stock exchanges and the National Association of Securities Dealers ("NASD"), Congress wanted to avoid adding yet another layer of expansive direct regulation in the securities industry. SIPC First Annual Report, 1971 p. 6. Nevertheless, Congress recognized that regulation and improvement of industry financial practices was essential in order to prevent insured losses from occurring. Thus, Congress, through 15 U.S.C. § 78iii, imposed the extant network of SEC/SRO rules and regulations on all SIPC members, with SIPC given an advisory role in refining and

developing the SROs' standards. SIPA § 78iii(c) provides that "[t]he self-regulatory organization of which a member of SIPC is a member or in which it is a participant *shall* inspect or examine such member for compliance with *applicable financial responsibility rules*. . . . " (emphasis added). Thus, the rules of the self-regulatory organizations are imposed, by SIPA, directly on all SIPC members just as surely as if those rules had been promulgated by SIPC itself.

SIPC itself has recognized the mandatory nature of SRO rules when it stated that "financial responsibility rules" include both the rules promulgated by the SEC and "rules prescribed by a national securities exchange." SIPC specifically acknowledged that the existing rules of the Exchanges and the National Association of Securities Dealers, Inc. ("NASD") were to be applied to SIPC members. SIPC 1971 Annual Report, pp. 30-31.

SIPC also has recognized SIPA's success in regulating the financial practices of SIPC members through the rules of the SROs:

> **SELF-REGULATORS EXAMINE SIPC MEMBERS**
>
> SIPA's Section 13 [78iii] was designed to upgrade the financial practices and responsibility of securities industry members over a period of time. [citing to 78iii(e)].
>
> * * *
>
> Improved broker-dealer operations and the combination of more stringent requirements for entering the securities business, *new financial responsibility rules*, and noticeable improvement in monitoring broker-dealer financial condition by the SEC and SROs since SIPC's inception *contributed to a sharp decline in the number of customer protection proceedings commenced in the late 1970s.*

Brochure entitled "SIPC and Customer Protection" published by SIPC (3rd Ed. April 1992) (emphasis added).

Even so, SIPC was not left without a role in the regulation process. Section 78iii(e) gave SIPC a statutory mandate ("shall") to review existing rules and regulations, and consult

with the SROs regarding strengthening of financial responsibility requirements. One of SIPC's first actions was to ask the Exchanges and the NASD for data regarding their rules so that SIPC could commence its review. SIPC First Annual Report, 1971, at p. 30 n. 49. Thus, SIPC participation in the regulatory process carries much weight in the development of additional regulations. The best example of SIPC's influence over the regulatory process is the instigation of the mandatory fidelity bonding requirement which is at the heart of this case and discussed in section "C", *infra*.

B. THE INSURANCE/REGULATORY ASPECTS OF SIPA AND SIPC ARE SIMILAR IN ALL MATERIAL RESPECTS TO THOSE OF THE FDIC/FSLIC.

The similarities between FDIC and SIPC are obvious. Just as SIPA's purpose is to protect individual customers from stockbroker failures and restore public confidence in the securities trading industry, "the policies [of the FDIC/FSLIC statutory schemes] are promoting the stability of, and confidence in, the nation's banking system." *Gunter v. M. Hutcheson*, 674 F.2d 862, 870 (11th Cir. 1982).

The regulatory scheme for insurance under SIPA is similar to the regulatory scheme for insurance of FDIC/FSLIC members. Each corporation has its membership of insured institutions defined by statute. *See* 15 U.S.C. § 78ccc(a)(2), (SIPC, e.g., persons registered as brokers and dealers under 1934 Securities Exchange Act); 12 U.S.C. §§ 1813(b), (d) and (h), §§ 1814 and 1815, (FDIC, e.g., includes banks that are members of Federal Reserve Board); and 12 U.S.C. §§ 1724 and 1726 (FSLIC). Each of these statutory corporations has its powers prescribed by statute, as well as the details for appointment of a board of directors. *See* 15 U.S.C. § 78ccc(b) and (c) (SIPC), 12 U.S.C. §§ 1812 and 1819 (FDIC), and 12 U.S.C. § 1725(a) and (c) (FSLIC). And SIPC, FDIC, and FSLIC all impose assessments on the respective member institutions. *See* 15 U.S.C. § 78ddd(c) (SIPC), 12 U.S.C. 1817(b) (FDIC), and 12 U.S.C. § 1727(b) (FSLIC); *and see*

Sowards and Mofsky, "The Securities Investor Protection Act of 1970", 16 Bus.Law 1271, 1277 (1971).[3]

Thus, as with FDIC and FSLIC, the securities dealer or broker that is forced into a liquidation by SIPC has the backing of a federal government-authorized insurance fund for the payment of customer claims, with limits on the amount of claims for each customer.[4] It is not surprising then, that courts often compare the functions of FDIC to SIPC. *See Securities and Exchange Commission v. Albert & Maguire Securities Co., Inc.*, 560 F.2d 569, 571 (3d Cir. 1977); *Securities and Exchange Commission v. Aberdeen Securities Co., Inc.*, 526 F.2d 603, 605 (3d Cir. 1975); *In re: Matter of Lewellyn*, 26 Bankr. 246, 253 (Bankr. D. Vir. 1982).

Even SIPC has made the comparison.[5] SIPC's 1986 information brochure discusses SIPC's legislative history:

> Representatives of the securities industry, the Federal Reserve Board, Office of Management and Budget, the Department of the Treasury, and the SEC conferred on draft bills proposed by the industry group and the SEC staff. *Their joint proposal would have created an organization performing a role in the securities industry somewhat similar to those established to insure depositors to banks, savings and loan associations and credit unions; that is, the Federal Deposit Insurance Corporation*

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[3] The FSLIC provisions were repealed by the Financial Institutions Reform, Recovery, and Enforcement Act (F.I.R.R.E.A.) of 1989, Pub. Law 101-73, Title IV, § 407, 103 Stat.363. All provisions set forth above with reference to FDIC are now also applicable to RTC.

[4] *See* 15 U.S.C. § 78fff-3(a) (SIPC limitation of $500,000 for cash and securities per customer, with maximum of $100,000 in cash) 12 U.S.C. 1821(a) (FDIC maximum of $100,000); 12 U.S.C. §§ 1724(b) and 1728 (FSLIC, same).

[5] SIPC's 1983 Annual Report compares FDIC, FSLIC and SIPC and states, on p. 14 under the heading "SIPC Image and Awareness Study", – "A majority of brokers (77%) report that their average customer understands that his accounts are insured."

(FDIC), Federal Savings and Loan Insurance Corporation (FSLIC) and National Credit Union administration (NCUA).

"SIPC and Customer Protection", (2d ed. April 1986), page 1.

Like FDIC/FSLIC, SIPC has extensive power to control the affairs and conduct examinations of its member corporations. The only difference is the mechanism: FDIC/FSLIC regulates and examines directly using their own rules and personnel while SIPC uses the self-regulating organizations in the securities industry (which have no parallel in the banking industry) as its agents for promulgating financial responsibility rules, examining members for compliance and reporting on member compliance to SIPC. This difference in mechanics, however, has no difference in substance. The bottom line is that both statutory schemes impose specific and extensive regulatory requirements on their respective industries.

C. SIPA REQUIRED GSC TO HAVE THE STANDARD INDUSTRY FORM FIDELITY BOND, WHICH CONTAINS THE PROVISION SIPC IS ATTEMPTING TO SELECTIVELY INVALIDATE DURING A TITLE 15 STOCKBROKER LIQUIDATION PROCEEDING.

SIPA itself required GSC to have the industry standard form fidelity bond. SIPC was instrumental in developing this requirement, and was fully aware of the content of the standard bond negotiated between the securities industry and the Surety Association of America, including the very provision of which SIPC now complains. One of SIPC's first priorities was the development of industry rules requiring bonding of SIPC members:

> SIPC recently received advice that some progress was being made by the NASD and the Commission with representatives of certain insurance companies on the subject of requiring bonding of brokers, or dealers doing a public securities business – *a matter raised by SIPC in 1971.*

SIPC First Annual Report, 1971, at p. 32 (emphasis added). The following year, SIPC reported that its efforts had been fruitful:

> Finally, as indicated in our first annual report, the Corporation has expressed concern that many brokers do not carry basic fidelity bonds. We have urged the Commission and the NASD to require brokers to obtain blanket fidelity bonding, and we are pleased to note that the membership of the NASD recently approved a proposal which authorized its board of Governors to require that NASD members, who are members of SIPC . . . obtain such bonds. . . . It is anticipated that the NASD will finalize action on this rule in the near future.

SIPC Second Annual Report, 1972, at p. 37. Thus, SIPC requested the SROs to develop bonding requirements, and had full knowledge that the SROs and the Surety Association of America worked together to develop the required bond.

The NASD rule developed in response to SIPC's request provides as follows:[6]

> Par. 2182 Fidelity Bonds
> Sec.32
> Application
>
> (a) Every member shall be required to carry a blanket fidelity bond meeting requirements as to form, amount and type of coverage as the Board of Governors may prescribe pursuant to the authorization granted by paragraph (b) hereof.
>
> * * *
>
> Par. 2182A APPENDIX C
> Coverage Required
>
> (a) Each member required to join the *Securities Investor Protection Corporation . . . shall:*
>
> (1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. . . .

(emphasis added). In the present case, the NASD was the self-regulatory organization with authority over GSC. The bond

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[6] The full text of the NASD Rule is set forth in the Appendix.

obtained by GSC was in fact the "standard form of Brokers Blanket Bond." Thus, through the "chain of command" set forth in § 78iii, SIPA required, and SIPC approved, GSC's bond.

SIPC attempted to gloss over this fact in their brief to the court below by stating that "maintenance of the bond is not a prerequisite to *SIPC* membership" and that *"SIPC itself* has no regulatory authority over its members, and no authority to require its members to purchase a bond." (SIPC Brief at 26) (emphasis added). While these statements are technically correct, they are deceptively phrased to divert attention from the fact that SIPA makes the self-regulatory organizations the "examining authorities" on behalf of SIPC, and gives those authorities power to enforce their own "financial responsibility rules" on behalf of SIPC.

Even more significant, SIPC concealed from the court its active role in seeking rules requiring brokers to carry bonds, and its knowledge of the development and substance of those rules. SIPC cited the applicable NASD rules, but failed to disclose that NASD promulgated those rules at SIPC's prompting and in full consultation with SIPC pursuant to § 78iii(e). In addition, SIPC did not quote the full language of the NASD rule, thus concealing that the rule specifically requires the "standard form of Brokers Blanket Bond" which contains the automatic termination provision SIPC now seeks to avoid.

D. BECAUSE THE STATUTORY SCHEMES GOVERNING SIPA AND THE FDIC/FSLIC ARE IDENTICAL IN THAT THEY APPROVE OF AND REQUIRE THEIR PARTICIPATING MEMBERS TO CARRY THE STANDARD BOND, CASES UPHOLDING THE "AUTOMATIC TERMINATION UPON TAKEOVER" PROVISION OF THE STANDARD BOND AS AGAINST FDIC/FSLIC MANDATE THE SAME RESULT AGAINST SIPC.

Cases involving the FDIC/FSLIC uniformly have upheld the termination provisions of bonds, similar to paragraph

12(c) of National Union's bond, upon takeover by state or federal officials. *California Union Insurance Co. v. American Diversified Savings Bank,* 948 F.2d 556 (9th Cir. 1991); *FDIC v. Aetna Casualty and Surety Co.,* 903 F.2d 1073 (6th Cir. 1990); *Sharp v. FSLIC,* 858 F.2d 1042 (5th Cir. 1988); *FSLIC v. Transamerica Insurance Co.,* 705 F.Supp. 1328 (N.D.Ill. 1989). The rationale of all of these cases is identical: where the government requires regulated entities to have a standard bond, the government cannot later selectively invalidate provisions of the bond which may work to its disadvantage.

In *Sharp v. FSLIC,* 858 F.2d 1042 (5th Cir. 1988), the FSLIC relied on common law theories of contract interpretation to invalidate the automatic termination provision. In rejecting these arguments the court observed that the FSLIC's position would fundamentally alter the contract:

> First, terminations by receivership or takeover can be distinguished from terminations by the insurer or insured, in that a fidelity bond insures the fidelity of the employees and officers of the bank. In the case of a receivership or a takeover, the officials who purchased the bond to insure their own honesty are no longer in control of the institution. Takeover or receivership would substantially alter the character of the risk covered by the policy.

858 F.2d at 1045-46. By this language, the Court recognized that takeovers pose special risks for insurers not contemplated by the bond, justifying immediate relief from coverage.

The Court also noted that the bankers' blanket bond was jointly drafted by the sureties and FSLIC members. The Court refused to invalidate the termination clause on the grounds that "[i]ndeed, FSLIC, which in this case has stepped into the shoes of the insured, is the very institution which required that Underwriters issue their coverage under Form 22 in the first place." 858 F.2d at 1046.

In its conclusion, the Court noted the equitable problems raised by FSLIC's attempt to selectively invalidate provisions of the bond:

> We are aware that the conclusion we have reached may seem harsh to FSLIC, an institution

> beleaguered by thousands of thrift failures nationwide. The harshness of the rule is softened by two considerations. First, it is FSLIC itself that has chosen to require coverage under Form 22 as a condition of FSLIC membership. If it wishes an additional time period for discovering losses subsequent to establishment of a conservatorship, FSLIC need only alter its regulations.
>
> * * *
>
> In the face of the clear language of Form 22, we hesitate to rewrite judicially a standard form bond that has had a longer existence than FSLIC. If FSLIC finds the coverage provided by Form 22 inadequate, it need only require member banks to purchase an additional discovery period in the event of a type (c) termination.

Id. at 1048. By this latter language, the court recognized that requiring, through regulation, additional coverage after a federal takeover would at least give the sureties notice of their expanded obligations, and enable them to reassess their risks and their premiums accordingly. To force the sureties to provide such additional coverage with no compensation, by governmental elimination of their bargained-for limitations on such coverage, would be inequitable and unwarranted.

The bottom line of *Sharp* is basic fairness: the government cannot give with one hand and take away with the other. The principles set forth in *Sharp* consistently reappear in every case where the FDIC/FSLIC has attempted to selectively invalidate the automatic termination clauses. Perhaps most important, courts have applied these principles to defeat the FDIC/FSLIC's efforts to invalidate the automatic termination provisions even where the FDIC/FSLIC relies upon its broad statutory authority to act as a receiver and liquidator of troubled banks.

In *FSLIC v. Transamerica Insurance Co.*, 705 F.Supp. 1328 (N.D.Ill. 1989), the FSLIC argued that its powers as a receiver to collect all obligations owing to the insured institution were only limited by regulation of the Federal Home Loan Bank Board, citing 12 U.S.C. § 1279. Since the automatic termination provisions placed limits on FSLIC's ability

to collect obligations owing under a fidelity bond, they violated FSLIC's broad statutory authority and could be invalidated. *Id.* at 1336. The court disagreed:

> For the same reasons [stated in *Sharp*], FSLIC's arguments regarding the unenforceability of [the automatic termination provision] must fail. Having required Glenn Ellyn [Savings and Loan] to procure a Form 22 bond, FSLIC simply cannot now be heard to complain about the enforceability of its provisions.

Id. at 1337. Subsequent appellate authority has consistently agreed with the approach in *Transamerica.*

In *FDIC v. Aetna Casualty and Surety Co.*, 903 F.2d 1073 (6th Cir. 1990), the FDIC, instead of relying on a specific statutory provision, successfully asserted in the district court that the termination clauses were "contrary to public policy because they 'preclude the FDIC from discharging its responsibility in connection with marshalling the assets of the failed bank.' " *Id.* at 1077. The Sixth Circuit rejected this position, and upheld the termination provisions.

The court noted that 12 U.S.C. § 1828(e) stated that the FDIC "may" require insured institutions to carry a fidelity bond. Thus, even though no evidence had been presented to indicate that the FDIC had in fact exercised that authority, *Id.* at 1078, the Court concluded that:

> It is clear from § 1828 that Congress is aware of fidelity insurance and could, if it so desired, require its procurement and could set terms which would avoid the problem created by [the automatic termination clauses].
>
> * * *
>
> The FDIC also has statutory authority to require bond coverage and could require that such bond continue upon the appointment of FDIC as a receiver. To rule otherwise would be to force Aetna to take on a risk for which it did not bargain.

Id. The court found that the reasoning in *Sharp* was applicable even (1) where the bond was not mandated by the statutory scheme and (2) where the FDIC was relying on its statutory

powers as receiver and not on the common law of contracts as the source of its authority to invalidate the termination clause. "[T]he FDIC's contention that existing laws justify the invalidation of [the automatic termination clauses] must fail. The dominant public policy exposed by this review is that the parties' freedom of contract must not be disturbed." *Id.*

In *California Union Insurance Co. v. American Diversified Savings Bank*, 948 F.2d 556 (9th Cir. 1991), FSLIC also argued that the automatic termination clause "violate[d] public policy because it 'infringe[d] on the power of the FSLIC to act as a receiver for failed institution.' " *Id.* at 562. The Court rejected this position, holding that:

> In this case, FSLIC required, pursuant to federal regulation, that the participating institutions maintain bond coverage in the form of Standard Form 22, or its equivalent. *See* 12 C.F.R. § 563.19(a) (1988). . . . FSLIC must be deemed to be aware of the provisions in the bond, and therefore in a position to alter the provisions and/or its regulations in order to provide additional time periods for it to discover losses. Consequently, we conclude that the Form 22 bond, with all of its provisions, is endorsed by the federal government by way of the federal agency responsible for the regulation of the savings and loan industry . . . through its requirement that the Standard Form 22 bond be used.

Id. The Court concluded that public policy supported the bond's automatic termination provisions.

The principles established in the *Sharp* line of cases are crucial to the present case because they preclude the government from invalidating bond provisions which it accepts under a statutory scheme, *regardless* of the breadth of its statutory authority as receiver and liquidator under other provisions of that scheme.

The *Sharp* cases should have compelled the same result in the present case. *Sharp* recognized that the fidelity insurance risk created by the installation of new management is substantially different from that originally bargained for by the surety. *Sharp*, 858 F.2d at 1045-46; *Aetna* 903 F.2d at 1078. This increased risk justifies automatic termination

because the FDIC/FSLIC appoints receivers or conservators to manage the bank who are different persons from the management which the surety agreed to insure. Like FDIC/FSLIC situations, SIPA liquidation proceedings require takeover of the institution and appointment of trustees by SIPC. *See* 15 U.S.C. § 78eee(b)(3). Thus, the enhanced insurance risk is identical to that which justifies automatic termination in the FDIC/FSLIC context.

The *Sharp* cases also recognized that these clauses are part of the standard fidelity policy developed through industry-wide negotiation between surety companies and the bonded companies. As the NASD standards and SIPC statements set forth above show, the sureties, SROs and securities dealers follow the exact same procedure for negotiating the standard Stockbrokers Blanket Bond. These facts are well known to Congress and to SIPC, and SIPC was the very entity which required member entities to have fidelity bonds. *See also Sharp* at 1046; *Aetna* at 1078; *California Union* at 562. Thus, SIPC had the power to require expanded coverage upon takeover, but did not do so, *Id. See also* 15 U.S.C. 78iii(e) (requiring SIPC to consult with the SROs concerning development of financial responsibility rules).

Finally, and most important, the *Sharp* cases establish that no matter how broad SIPC's liquidation authority might be, it is not broad enough to permit SIPC to invalidate contacts which SIPA has required and SIPC has accepted. SIPC specifically requested the development of bonding requirements, which directly led to the NASD rules applicable in this case. SIPC was fully aware of the SRO/insurance industry negotiations leading to the standard bond form. SIPA then imposed the bond form used in the present case on all SIPC members. Having accepted this standard bond as drafted, SIPC has no right to selectively invalidate provisions which do not suit its purpose during liquidation proceedings. The *Sharp* cases all mandate this obligation of consistency and basic fairness.

E. THE ELEVENTH CIRCUIT'S DECISION DIRECTLY CONFLICTS WITH THE DECISIONS OF THE FIFTH, SIXTH AND NINTH CIRCUIT COURTS OF APPEAL AND SHOULD BE REVERSED BY THIS COURT.

The Eleventh Circuit, in its opinion, offerred only the following explanation of why it refused to apply the rationale of the *Sharp* cases:

> That analogy is inapposite; the cited cases do not involve the bankruptcy code, and those institutions [FDIC/FSLIC] are not debtors in title 11 bankruptcy proceedings.

In re: Government Securities Corp., 972 F.2d at 331, n. 6. Not only did the Court ignore all of the facts which make this case identical to the *Sharp* cases, the one reason which it gave for distinguishing those cases is not a valid legal basis for making such a distinction.

It is true that FDIC/FSLIC liquidation proceedings do not rely on the provisions of the bankruptcy code. Application of Bankruptcy Code provisions, however, would not have made any difference in the *Sharp* cases, and there is no legally valid reason why it should make a difference here. In *Aetna, California Union* and *Transamerica,* the FDIC/FSLIC claimed that their own broad statutory authority to act as receiver and collect obligations owing to the failed bank permitted them to invalidate the automatic termination provisions of the bond. Although Bankruptcy Code provisions were not involved, the FDIC/FSLIC relied on statutory liquidation authority which was at least as broad as 11 U.S.C. § 541(c)(1)(B). *See, Aetna, supra,* 903 F.2d at 1077 (statutory power to marshall assets); *California Union, supra,* 948 F.2d at 562 (FDIC statutory power to act as receiver); *Transamerica, supra,* 709 F.Supp. at 1337 (FSLIC cited 12 U.S.C. § 1279, giving it plenary authority to collect obligations owing to the bank).

In each case, however, the courts ruled that these broad statutory powers during liquidation were not the controlling issue. The relevant inquiry was not the *scope* of government power under a single liquidation provision, but the *consistent exercise* of government power under the overall statutory

scheme. *See, Sharp, supra,* 858 F.2d at 1048; *Aetna, supra,* 903 F.2d at 1078; *California Union, supra,* 948 F.2d at 562; *Transamerica, supra,* 705 F.Supp. at 1337.

Thus, the reason advanced by the Eleventh Circuit for distinguishing this case from the *Sharp* cases is legally invalid.[7] Since the court offerred no legally supportable justification for its different conclusion, its decision must be seen as in direct conflict with the *Sharp* decisions. For all of the reasons set forth above, the *Sharp* cases reach reasonable, just and inevitable conclusions given their facts. Since the facts in the present case are identical in all material respects, this Court should reverse the decision of the Eleventh Circuit, and rule that SIPC is bound to accept the terms of the bond.

F. PERMITTING SIPC TO SELECTIVELY INVALIDATE THE BOND BY USING 11 U.S.C. § 541(c)(1)(B) ALSO WOULD BE INCONSISTENT WITH THE REQUIREMENTS OF 15 U.S.C. § 78iii, AND WOULD VIOLATE 15 U.S.C. § 78fff.

In addition to the case law set forth above, SIPA itself prohibits SIPC from acting inconsistently with the provisions of SIPA during a stockbroker liquidation proceeding. The fundamental flaw in SIPC's entire position is its belief that the broad bankruptcy powers granted to SIPC permit SIPC to do anything, even if it is inconsistent with actions required or approved of in other sections of SIPA.

It bears emphasizing that 15 U.S.C. § 78fff provides as follows:

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[7] The Court's statement that FDIC/FSLIC are not "debtors in title 11 bankruptcy proceedings" is both an irrelevant statement, and incorrect insofar as it implies that SIPC is such a debtor. The failed SIPC member is the debtor. § 78eee(a)(3). SIPC is the federally established and backed insurer of the failed firm's customers. SIPC is the instigator of the liquidation proceedings. SIPC is no more a "debtor" than is FDIC/FSLIC. In any event, the Court offerred absolutely no explanation of how SIPC's supposed "debtor" status should lead to a different result from the *Sharp* cases.

(b) Application of Title 11

> *To the extent consistent with the provisions of this chapter,* a liquidation proceeding shall be conducted in accordance with and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of Title 11.

(emphasis added). Although SIPA's provisions governing liquidation of firms are important, they comprise only one aspect of SIPA's overall scheme for protection of customers. Thus, the SIPA liquidation trustee may only "conduct" the liquidation using Bankruptcy Code powers if his "conduct" pursuant to those powers does not undo requirements imposed by other provisions of SIPA. It is critical to note that the policy expressed in SIPA is identical to the policy of consistency which underlies the *Sharp* cases.

In the present case, SIPA, through § 78iii and applicable SRO rules, has required SIPC members to carry the standard bond. SIPC, pursuant to its mandate under § 78iii, specifically requested the SROs to develop rules for mandatory bonding of SIPC members. The SROs responded, with SIPC's approval, by negotiating standard bonding requirements with the surety companies. Once the SROs promulgated their rules requiring the standard bond, SIPA § 78iii made those rules and those bonds mandatory for SIPC members. This history of the bonding requirement shows Congressional and SIPC approval of the bond and "all of its provisions," *California Union,* 948 F.2d at 562.

However broad SIPC's powers are under the "liquidation" provisions, they are not broad enough to allow SIPC to repudiate statutory requirements contained in other parts of SIPA itself, including the bonding requirements imposed by § 78iii. Thus, SIPC's actions in invoking 11 U.S.C. § 541 to invalidate the automatic termination provisions of the bond may be overturned without addressing the issue of whether Section 541 is "incorporated" into SIPA wholesale. Even if it was, the particular "conduct" of the SIPC trustee pursuant to section 541 is inconsistent with other provisions of SIPA.

The Eleventh Circuit, in its opinion, expressed concern about not adopting a position which would render provisions

of SIPA "essentially meaningless." *In re Government Securities Corp.*, 972 F.2d at 331. The Eleventh Circuit, however, did that very thing when it allowed SIPC to use § 78fff to override the requirements of § 78iii. The decision opens the way for SIPC and its trustees to invalidate a variety of regulatory requirements which have been imposed on SIPC members, including contracts involving the rights of third parties. This point of law – the reconciling of SIPA's liquidation provisions with its regulatory scheme – is a critical question of law which should be formally resolved by this Court.

POINT II

THE ELEVENTH CIRCUIT'S HOLDING THAT ALL OF THE BANKRUPTCY CODE PROVISIONS DESIGNATED IN SIPA § 78fff(b) ARE COMPLETELY INCORPORATED BY REFERENCE INTO SIPA CONFLICTS WITH CONTRARY STATEMENTS BY THE SECOND AND THIRD CIRCUITS ON THE SAME POINT OF LAW, AND PURPORTS TO RESOLVE AN IMPORTANT ISSUE OF FEDERAL LAW BEST RESOLVED BY THIS COURT.

The Eleventh Circuit held that the SIPC trustee could invalidate the automatic termination provisions of National Union's bond because the **anti-ipso-facto** provisions of 11 U.S.C. § 541(c)(1)(B) are incorporated by reference into SIPA by means of 15 U.S.C. § 78fff. The Eleventh Circuit's decision did not take into account the different policy objectives and structures of SIPA and the Bankruptcy Code, and the language and legislative history of the respective statutes.

Section 78fff does not incorporate all of the referenced provisions of the Bankruptcy Code. By referring only to the "conduct" of SIPA liquidation proceedings, Congress only intended to make bankruptcy procedures available in SIPA proceedings. A bankruptcy trustee's substantive rights are not incorporated *in toto*. The Eleventh Circuit's adoption of "wholesale" incorporation of all procedural and substantive

provisions of the Bankruptcy Code directly conflicts with the decisions of the Second and Third Circuits.

Next, the language and legislative history of Section 541(c)(1)(B) itself indicates that Congress did not intend to make its provisions applicable in SIPA liquidation proceedings. More important, although many provisions of SIPA and the Bankruptcy Code expressly make provisions of the Code applicable in SIPA proceedings, none refer to § 541. The extent of the Bankruptcy Code's incorporation into SIPA is an important issue of federal law which should be resolved by this Court.

A. THE PUBLIC POLICY AND PURPOSE OF SIPA DIFFERS SUBSTANTIALLY FROM THE POLICY AND PURPOSE OF LIQUIDATION UNDER THE BANKRUPTCY CODE AND THIS DIFFERENCE SUPPORTS LIMITING SECTION 541(c)(1)(B) TO A BANKRUPTCY CODE LIQUIDATION.

There is a fundamental and significant difference between liquidation proceedings under SIPA and under the Bankruptcy Code.

> The institution of a case under SIPA brings a pending bankruptcy liquidation to a halt and from that point forward, while in many respects paralleling a bankruptcy liquidation, *the liquidation proceeds separate from the Bankruptcy Code with a different primary policy orientation, that of protection of certain public customers.* For protection, such public customers through the SIPA trustee may look to the Securities Investors Protection Corporation (SIPC) for satisfaction of their claims. . . .
>
> * * *
>
> The essential difference between a liquidation under the Bankruptcy Code and one under SIPA is that under the Code the trustee is charged with converting securities to cash as quickly as possible and, with the exception of the delivery of customer name securities, making cash distributions to customers of the debtor in satisfaction of their claim. *A SIPC trustee, on the other hand, is required to distribute*

> *securities to customers to the greatest extent practicable in satisfaction of their claims against the debtor. There is, manifestly, a fundamental difference in orientation between the two proceedings. . . .* (emphasis supplied) (citations omitted)

4 Collier on Bankruptcy, Subchapter Three, Stockbroker Liquidation, Introduction 2 and 5 (15th ed. 1979).

SIPC has previously candidly recognized the distinction in its own publication:

> *"The liquidation is carried out under the special procedures of the 1970 act which, while they draw upon certain aspects of the Bankruptcy Act, are quite different in their operation from the latter Act.* These procedures give effect to the unique nature of the securities business and the intent of the Congress to make evident to investors the governmental concern with and commitment to the public interest and public confidence in our securities markets." (emphasis supplied)

SIPC's 1973 Annual Report, p. 6.

Reflecting this difference in purpose, a SIPA liquidation differs considerably in its operation from a bankruptcy proceeding. For example, in a SIPA liquidation, the court must appoint the persons that SIPC specifies as the liquidation trustee and its counsel. 15 U.S.C. § 78eee(b)(3). Customer claims in a SIPA proceeding must be filed within sixty (60) days publication of the SIPA liquidation notice, § 78fff-2(a)(3), but in a Chapter 7 bankruptcy the proofs of claim are to be filed within ninety (90) days after the first date for the section 341(a) meeting of creditors which meeting is set at a reasonable time after the order for relief. 11 U.S.C. § 341(a); Bankruptcy Rule 3002(c).

The Bankruptcy Code defines debtor as "[a] person or municipality concerning which a case under this title [Title 11] has been commenced," 11 U.S.C. § 101(12). The SIPA definition of debtor is much narrower: "a member of SIPC with respect to whom an application for a protective decree has been filed under section 5(a)(3) [15 U.S.C. § 78eee(a)(3)] or a direct payment procedure which has been instituted under section 10(b) [15 U.S.C. § 78fff-4(b)]." 15 U.S.C. § 78lll(5).

It is quite clear that a SIPA proceeding is not an ordinary bankruptcy proceeding. SIPA does not even apply the Bankruptcy Code's specific provisions for a stockbroker liquidation contained in 11 U.S.C. § 741-752. The two proceedings are entirely distinct. Thus, substantive provisions of the Bankruptcy Code such as 11 U.S.C. § 541 should not be incorporated into SIPA absent clear direction from Congress to do so.

B. SECTION 78fff(b) ONLY INCORPORATES PROCEDURAL AND JURISDICTIONAL PROVISIONS OF THE BANKRUPTCY CODE INTO SIPA, AND THE ELEVENTH CIRCUIT'S HOLDING TO THE CONTRARY CONFLICTS WITH HOLDINGS OF THE SECOND AND THIRD CIRCUITS ON THE SAME POINT OF LAW.

Section 78fff(b)'s emphasis on the "conduct" of proceedings and "consistency" shows that it only incorporates those procedural provisions of the Bankruptcy Code which are consistent with SIPA.

Courts consistently have recognized that the phrasing of § 78fff(b) does not amount to a wholesale incorporation by reference of all of the referenced provisions of the bankruptcy code:

> We note that [78fff(c)(1)][8] does not in express terms incorporate the provisions of Chapter X, but merely states that the SIPA "liquidation proceeding shall be conducted in accordance with, as as though it were being conducted under, the provisions of Chapter X. . . . "
>
> * * *
>
> Thus, § [78fff(c)(1)] is intended to make the flexible Chapter X *procedures* available for SIPA liquidations. . . . Only those provisions relating to the procedures for conducting the affairs of the estate

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[8] The cite is to SIPA prior to the 1978 amendments to the bankruptcy code and the associated change in SIPA now set forth in 78fff(b). The relevant wording of § 78fff(c)(1) is identical to the wording of § 78fff(b).

> during bankruptcy administration, except as inconsistent with the provisions of SIPA, have been incorporated.

S.E.C. v. Aberdeen Securities, Inc., 526 F.2d 603, 605 (3rd Cir. 1975) (emphasis by the court). *Aberdeen* went on to holding that Bankruptcy Act provisions for an award of attorneys fees in connection with services rendered to the estate is not incorporated into SIPA.

In *Redington v. Touche, Ross & Co.*, 612 F.2d 68 (2d Cir 1979), the court faced the issue of whether SIPA incorporated the Bankruptcy Act's provisions allowing shareholders to be heard in connection with bankruptcy proceedings. The court noted that:

> Congress' clear purpose in writing § [78fff(c)(1)] of SIPA in the manner chosen was to structure SIPA liquidations, *insofar as the SIPA court's powers with regard to jurisdiction and procedure are concerned,* on the model [of a bankruptcy court]. Thus, § [78fff(c)(1)] gives SIPA liquidation courts the procedural and jurisdictional powers conferred on a [bankruptcy court].

Id. at 71-72 (emphasis added). Although *Touche, Ross* involved jurisdictional issues and not procedural ones, the court's discussion emphasizes that the specific language used by Congress in § 78fff means that Congress has a "clear purpose" *not* to incorporate non-procedural aspects of bankruptcy law into SIPA.

Although *Aberdeen* and *Touche, Ross* were decided under SIPA and the Bankruptcy Act prior to the 1978 amendments creating the Bankruptcy Code, the reasoning of the cases is still applicable. There is no indication in the legislative history of the 1978 amendments to the Bankruptcy Code, or in the 1978 amendments to SIPA (*see* Public Law 95-598), indicating that the new substantive provisions of the Bankruptcy Code, including section 541(c)(1)(B), were to be incorporated wholesale into SIPA. The amendments to 15 U.S.C. § 78fff(b) were merely to change the cross-reference of Chapter X of the Bankruptcy Act to instead reference the new

Bankruptcy Code. Congress, presumably aware of the *Aberdeen* court's reasoning, elected to use exactly the same relevant language in § 78fff(b).

Thus, the "incorporation" inquiry in all instances must proceed on a case-by-case basis focusing on (1) whether the Bankruptcy Code provision is procedural, (2) whether the text of the provision is on its face inconsistent with SIPA, and (3) whether the "conduct" sought to be justified by the provision is inconsistent with SIPA. In the present case, the trustee's use of 11 U.S.C. § 541(c)(1)(B) does not meet the first element, and most definitely does not meet the third.

The Eleventh Circuit ignored the above case law in favor of an eyes-closed "blanket incorporation" approach:

> The plain language of § 78fff(b) makes no such [procedural-substantive] distinction, and explicitly incorporates Chapters 1, 3, 5, and subchapters I and II of Chapter 7 of the Bankruptcy Code.

972 F.2d at 330, n.1. Not only does this language directly conflict with the reasoning of the Second and Third Circuits, it ignores the careful phrasing of the statute itself.

C. 11 U.S.C. § 541(c)(1)(B) IS A SUBSTANTIVE PROVISION OF THE BANKRUPTCY CODE WHICH IS NOT INCORPORATED BY REFERENCE INTO SIPA.

The Eleventh Circuit's conclusion that section 541(c)(1)(B) applies to a SIPA liquidation proceeding is erroneous for two reasons. Section 541(c)(1)(B) clearly states, twice, that its application is limited to the commencement of a case under Title 11. Nothing in the section's legislative history supports a reading that extends its application to SIPA proceedings. Second, both SIPA and the Bankrutpcy Code explicitly designate which Code provisions are applicable in SIPA – Section 541 is not among them.

Section 541(c)(1)(B) states that:

> (c)(1) . . . [A]n interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement . . .

> (B) that is conditioned on the insolvency of financial condition of the debtor, on the *commencement of a case under this title [i.e., Title 11 U.S.C. 1, or on the appointment of or taking possession by a trustee in a case under this title [i.e., Title 11 U.S.C.*]. . . . (emphasis added)

The language of section 541(c)(1)(B) clearly and without ambiguity provides that an *ipso facto* clause triggered by a filing of a case under Title 11 is void. No mention is made of a case commenced under Title 15. If Congress had intended for section 541(c)(1)(B) to apply to a SIPA proceeding it easily could have stated "the commencement of a case under this Title or Title 15".

The legislative history of section 541(c)(1)(B) also does not support the district court's conclusion.[9] The legislative history of section 541(c)(1)(B) states as follows:

> Subsection (c) invalidates restrictions on the transfer of property of the debtor, in order that all of the interests of the debtor in property will become property of the estate. The provisions invalidated are those that restrict or condition transfer of the debtor's interest, and those that are conditioned on the insolvency or financial condition of the debtor, *on the commencement of a bankruptcy case*, or on the appointment of a custodian of the debtor's property.[10] (emphasis added)

The legislative history is completely consistent with the literal wording of the statute. Moreover, Congress had three opportunities to clearly expand section 541(c)(1)(B) to SIPA proceedings: when it was first enacted in 1978, and in the 1982 and 1984 amendments to the Bankruptcy Code. It did not do so.

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[9] Legislative History P.L. 95-598 U.S. Code Congressional and Administrative News, 95th Cong. 2d Sess., p. 5869.

[10] *Id.*

In addition, an examination of SIPA and the Bankruptcy Code specifically shows that Congress did explicitly incorporate into SIPA those substantive Code provisions which Congress deemed appropriate. By not so incorporating § 541, Congress must have intended to exclude it.

SIPA explicitly incorporates specific substantive provisions of the Code. *See* § 78eee(b)(1)(A) (adopting Code definition of insolvency in 11 U.S.C. § 101; § 78eee(b)(2)(B)(iii) (permitting trustee to abrogate right of set-off as provided in 11 U.S.C. § 553); 78fff(e) (adopting priorities of distribution in 11 U.S.C. § 726 and providing for SIPC to recoup funds as set forth in 11 U.S.C. § 507(a)(1)); and 78fff-1(b) (imposing on trustee same duties set forth in 11 U.S.C. Chapter 7). Most important to the present case, SIPA specifically incorporates the Code's powers for a trustee to avoid preferences. 11 U.S.C. § 547, and to invalidate certain transfers, 11 U.S.C. § 549. These powers are very similar in nature and purpose to that established in § 541, yet Congress specifically included these provisions in SIPA while omitting § 541. In addition, in 1982, Congress amended the "automatic stay" provision of the Code, 11 U.S.C. § 362(a), so as to make it expressly applicable in SIPA proceedings.

Thus, Congress clearly felt that 15 U.S.C. § 78fff(b) with its "conducted in accordance with" provision failed to incorporate either the automatic stay for SIPA cases, or the numerous substantive Code provisions set forth above. Section 78fff(b) is not as all-encompassing as SIPC contends.[11] All of this is consistent with the limited scope of § 78fff's careful language, as the *Aberdeen* and *Touche, Ross* cases have explained.

The Eleventh Circuit repeatedly expressed concern that § 78fff(b) would be rendered meaningless if either SIPA or

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[11] Indeed, SIPC was concerned with this omission and accordingly Theodore H. Focht, the General Counsel of SIPC, testified at the 1981 hearing of a House Sub-Committee, considering amendments to the Bankruptcy Code, in favor of amending section 362(a) to extend the automatic stay provisions to a SIPA proceeding. H.R. Report No. 97-420, 97th Cong. 2d Sess., U.S. Code Cong. and Admin. News (1982) 583, 584.

the Bankruptcy Code had to specify which substantive provisions of the Code were applicable in SIPA proceedings. Yet, ironically, *all* of the SIPA and Code provisions set forth above would have absolutely no purpose, and indeed would be totally extraneous and unnecessary, if the Eleventh Circuit's (and SIPC's) interpretation of § 78fff(b) are correct.

The Eleventh Circuit's "all or nothing" approach is inapposite. SIPA § 78fff(b) does make Bankruptcy Code provisions applicable in SIPA liquidation proceedings, but only to a limited degree and subject to specific conditions. Only procedural and jurisdictional provisions of the Code are applicable, and these must be actually applied only in a manner consistent with other provisions of SIPA. Substantive provisions of the Code will only apply where either SIPA or the Code itself so provides. Since no such language makes § 541(c)(1)(B) applicable, and since the use of § 541(c)(1)(B) to invalidate provisions of National Union's bond would be inconsistent with SIPA provisions requiring that bond, § 541(c)(1)(B) is not applicable in the present case.

CONCLUSION

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA. respectfully submits that the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

KIMBRELL & HAMANN, P.A.
Suite 900 - Brickell Centre
799 Brickell Plaza
Miami, Florida 33131-2805
(305) 358-8181

By: /s/ Guy W. Harrison
GUY W. HARRISON
CARL K. HOFFMAN
JAMES F. CROWDER, JR.
Attorneys for Petitioner,
NATIONAL UNION FIRE
INSURANCE COMPANY OF
PITTSBURGH, P.A.

In re GOVERNMENT SECURITIES CORPORATION, *Debtor.*

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., Defendant-Appellant,

v.

John R. CAMP, Jr., Trustee, Securities Investor Protection Corporation, Plaintiffs-Appellees.

No. 90-5356.

United States Court of Appeals, Eleventh Circuit.

Sept. 14, 1992.

Appeal from the United States District Court for the Southern District of Florida.

Before TJOFLAT, Chief Judge, DUBINA, Circuit Judge, and HENDERSON, Senior Circuit Judge.

TJOFLAT, Chief Judge:

In this case, we affirm the district court's holding that the Bankruptcy Code anti-termination provision, 11 U.S.C. § 541(c)(1)(B) (1988), applies to a liquidation proceeding under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa-78*lll* (1988) (SIPA), to invalidate a fidelity bond clause that purports to terminate liability under the bond automatically upon the takeover of the bonded entity by a receiver or other liquidator.

I.

The appellant, National Union Fire Insurance Company of Pittsburgh, PA. (NUFIC), issued a fidelity bond in February 1987 to the Government Securities Corporation (GSC), a securities broker, to protect it against losses resulting from, among other things, dishonest acts of its employees. Section 12(c) of the bond purports to terminate or cancel the bond "upon the taking over of [GSC] by a receiver or other liquidator."

On May 12, 1987, the Securities Investor Protection Corporation (SIPC) applied to the United States District Court for the Southern District of Florida for an order placing GSC into SIPA liquidation proceedings because of substantial shortfalls in GSC's accounts. That same day, GSC consented to the entry of an order appointing a trustee for the liquidation of its business pursuant to SIPA. The district court ordered the GSC liquidation to commence under SIPA, appointed John R. Camp, Jr. (Trustee) as trustee to administer the proceeding, and referred the case to the Bankruptcy Court for the Southern District of Florida.

On June 2, 1987, the Trustee, acting on behalf of GSC, notified NUFIC of a possible loss arising from employee dishonesty, and on December 1, 1987, filed a proof of loss. In response, NUFIC refused coverage under the bond on the ground that by virtue of section 12(c), the bond terminated on May 12, 1987, upon the appointment of the Trustee to oversee GSC's liquidation.

In August of 1988 the Trustee initiated an adversary proceeding against NUFIC within the SIPA liquidation proceeding, seeking a declaration of the rights of the

parties under the bond. The Trustee argued that NUFIC remained liable on the bond despite the commencement of the SIPA liquidation proceeding because the bond's automatic termination provision was invalidated by 11 U.S.C. § 541(c)(1)(B), the Bankruptcy Code anti-termination provision, which is made applicable to SIPA liquidation proceedings by 15 U.S.C. § 78fff(b). Section 541(c)(1)(B) forbids the courts from enforcing contract provisions that are conditioned upon the financial condition of the debtor. That section provides in relevant part:

> (c)(1) . . . an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement . . .
>
> > (B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

11 U.S.C. § 541(c)(1)(B).

The Trustee argued that SIPA proceedings import this, among other Bankruptcy Code provisions, through 15 U.S.C. § 78fff(b) which provides: "To the extent consistent with the provisions of [SIPA], a [SIPA] liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of [the Bankruptcy Code]."

The bankruptcy court agreed, and accordingly entered judgment for the Trustee reasoning that:

> the Trustee's rights under the bond constitute and constituted property of the estate under Section 541 of the [Bankruptcy] Code and the automatic termination provision contained in Section 12(c) of the bond is and was ineffective by virtue of Section 541(c)(1)(B) notwithstanding the commencement of the liquidation of GSC under S.I.P.A. and the appointment of Mr. Camp as Trustee. The rights, powers, and protection given to a bankruptcy trustee by the [Bankruptcy] Code are adopted by reference into S.I.P.A., 15 U.S.C. Sections 78fff(b), 78fff-1(a).

In re Government Sec. Corp., 101 B.R. 343, 346-47 (Bankr.S.D.Fla. 1989).

NUFIC appealed the bankruptcy court's decision to the district court, and that court affirmed. The district court found that "11 U.S.C. Section 541(c)(1)(B) applies to SIPA liquidation proceedings, thereby invalidating Section 12(c), the automatic termination clause of the bond NUFIC issued to GSC." *In re Government Sec. Corp.*, 111 B.R. 1007, 1010 (S.D.Fla.1990). NUFIC then lodged this appeal. We agree with the district court and therefore affirm.

II.

The sole issue presented in this appeal is whether section 541(c)(1)(B) of the Bankruptcy Code applies in a SIPA liquidation proceeding. NUFIC makes several arguments contending that the bond provision terminating

coverage upon a takeover should not be affected by section 541(c)(1)(B). We reject them all.

First, NUFIC posits that the plain meaning of section 541(c)(1)(B) demonstrates that it does not apply in a SIPA proceeding.[1] It argues that since this section speaks only of cases commenced under title 11 and not of cases commenced under title 15,[2] this section does not apply to the latter. In effect, NUFIC argues that in order to apply to a SIPA proceeding, a Bankruptcy Code provision must state specifically that it applies.

Apart from misreading the language of section 541(c)(1)(B), this argument completely ignores section 78fff(b) which plainly states that SIPA liquidation proceedings shall be conducted in accordance with certain provisions of title 11, including Chapter 5 in which section 541(c)(1)(B) is located. NUFIC's interpretation of section 541(c)(1)(B) would render section 78fff(b) meaningless. There would be no need for section 78fff(b) if each Bankruptcy Code section that applied in a SIPA

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[1] In addition, the appellant contends that the plain meaning of § 78fff(b) of SIPA shows that § 541(c)(1)(B) of the Bankruptcy Code is not incorporated into a SIPA liquidation proceeding. NUFIC claims that § 78fff(b) incorporates only the procedural and not the substantive aspects of the Bankruptcy Code insofar as they are consistent with SIPA. This argument is entirely meritless. The plain language of § 78fff(b) makes no such distinction, and explicitly incorporates Chapters 1, 3, 5, and subchapters I and II of Chapter 7 of the Bankruptcy Code.

[2] The appellant highlights the phrases "commencement of a case under this title [title 11]," and "taking possession by a trustee in a case under this title [title 11]" in § 541(c)(1)(B) to make this argument.

proceeding had to indicate it. It is a standard rule of construction that "a court should interpret a statute so as to give effect to each of its provisions." *United States ex rel. Williams v. NEC Corp.*, 931 F.2d 1493, 1502 (11th Cir.1991) (citing *United States v. Menasche*, 348 U.S. 528, 538-39, 75 S.Ct. 513, 519-20, 99 L.Ed. 615 (1955)). We cannot construe section 541(c)(1)(B) such that section 78fff(b), an integral component of SIPA, is rendered useless. We thus agree with the lower courts in holding that section 78fff(b) specifically incorporates section 541(c)(1)(B) into a SIPA proceeding.[3]

Similarly, NUFIC contends that Congress' amending of the automatic stay provision of the Bankruptcy Code, 11 U.S.C. § 362(a), in 1982 to make it applicable upon the filing of a SIPA proceeding,[4] but neglecting to amend

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[3] This reasoning answers two other arguments that NUFIC puts forth. First, NUFIC claims that the legislative history of § 541(c)(1)(B) shows that the section was not to apply to a SIPA proceeding. They cite the Senate Report which states that "[t]he provisions invalidated are those that restrict or condition transfer of the debtor's interest, and those that are conditioned on the insolvency or financial condition of the debtor, on the commencement of a bankruptcy case, or on the appointment of a custodian of the debtor's property." S.Rep. No. 989, 95th Cong., 2d Sess. 83 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5869. This quotation does not support the weight of their argument.

Further, NUFIC asserts that the legislative history of § 541(c)(1)(B) is "in derogation of the common law," requiring the statute to be strictly construed. No matter how strictly we construe § 541(c)(1)(B), it cannot entirely negate the effect of § 78fff(b).

[4] Section 362(a) now provides:

> Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of [title

section 541(c)(1)(B) shows that Congress did not intend that section 541(c)(1)(B) apply in a SIPA proceeding. This argument too must fail. Apart from the technical reasons for section 362(a)'s amendment,[5] this argument suffers from the fatal flaw discussed above. That is, NUFIC's contention also requires each Bankruptcy Code provision specifically to state that it applies in a SIPA proceeding. We reiterate that this reasoning renders section 78fff(b) essentially meaningless, and is unacceptable.

Finally, NUFIC claims that the public policy and purpose of SIPA differ substantially from the policy and purpose of liquidation under the Bankruptcy Code. This distinction, NUFIC contends, supports the proposition that Congress intended to limit application of section 541(c)(1)(B) to a Bankruptcy Code liquidation. Specifically, the customer protection aspect of SIPA renders the proceeding so different from a proceeding in ordinary bankruptcy that section 541(c)(1)(B) cannot be deemed to apply.

> 11], or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities. . . .

11 U.S.C. § 362(a) (1988).

[5] The legislative history indicates that 11 U.S.C. § 362(a) (1988) was amended for technical clarification in order to protect further the securities consumer in the event of a brokerage house liquidation. Congress clearly meant to increase, not decrease, protection to the consumer and the availability of the Bankruptcy Code in a SIPA proceeding. *See* H.R. 420, 97th Cong., 2d Sess. (1982), *reprinted in*, 1982 U.S.C.C.A.N. 583.

This argument is inapposite to the intent of SIPA. The purpose of SIPA is to return to customers of brokerage firms their property or money. 15 U.S.C. § 78fff(a) provides that "[t]he purposes of a liquidation proceeding shall be . . . to deliver customer name securities to or on behalf of the customers of the debtor . . . ; and . . . to distribute customer property and . . . otherwise satisfy net equity claims of customers. . . . " Congress wanted more, not fewer, assets available for customers of brokerage firms in financial distress. It makes no sense to suggest that Congress intended that the SIPA trustee have less power than an ordinary bankruptcy trustee to gather assets into the debtor's estate. It is entirely consistent with SIPA that the Trustee is able to recover any claims GSC has on the bond, in addition to any monies that GSC will receive for their customers from the SIPC. The two entities as potential sources of money are not mutually exclusive, but they are different forms of insurance upon which GSC may collect, create an estate, and distribute to creditors.[6]

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[6] NUFIC also contends that as a policy matter SIPC should be considered analogous to the FDIC and FSLIC, and cites cases involving those institutions where similar bond termination clauses have been upheld. *See, e.g., Sharp v. Federal Sav. & Loan Ins. Corp.*, 858 F.2d 1042 (5th Cir.1988); *Continental Ins. Co. v. Federal Sav. & Loan Insur. Corp.*, No. CV 84-9708 AHS (C.D.Cal.1986). That analogy is inapposite; the cited cases do not involve the bankruptcy code, and those institutions are not debtors in title 11 bankruptcy proceedings.

III.

For the foregoing reasons, the order of the district court is AFFIRMED.

IT IS SO ORDERED.

UNiTED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 89-1211-CIV-SPELLMAN

In re

GOVERNMENT SECURITIES CORP.,

Debtor

MEMORANDUM OPINION

JOHN R. CAMP, JR., Trustee, and the SECURITIES INVESTOR PROTECTION CORP.

(Entered March 16, 1990)

Appellees,

v.

NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA,

Appellant.

ORDER AFFIRMING BANKRUPTCY COURT

THIS CAUSE comes before the Court upon the appeal of National Union Fire Insurance Company of Pittsburgh, Pennsylvania (hereinafter "NUFIC"), from a decision of the Bankruptcy Court for the Southern District of Florida, in a declaratory judgment action brought by John R. Camp, Jr., as Trustee for the liquidation of Government Securities Corporation (hereinafter "GSC") seeking a determination of the estate's rights under a fidelity bond in light of 11 U.S.C. Section 541(c)(1)(B).

BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction of this appeal pursuant to 28 U.S.C. Section 158(a).

STANDARD OF APPELLATE REVIEW

On an appeal from a proceeding pursuant to the Securities Investor Protection Act (hereinafter "SIPA") a district court is to conduct a *de novo* review of the bankruptcy court's conclusions of law. *In re Stalvey & Assocs.*, 750 F.2d 464, 468 (5th Cir. 1985). However, the bankruptcy court's "[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Bankr. R. 8013.

BACKGROUND

On February 1, 1987, NUFIC issued a Securities Dealer Blanket Bond No. 959-9000 to GSC. Coverage on the bond was to commence on February 1, 1987 and continue through November 1, 1987. GSC paid the premium on the bond in full prior to its issuance.

On an application and complaint by the Securities Investor Protection Corporation (hereinafter "SIPC"), this Court (per Hastings, J.) entered an order on May 12, 1987, pursuant to 15 U.S.C. Section 78 aaa(5)(a), placing GSC, a broker-dealer in U.S. government securities, into liquidation under SIPA and appointing John R. Camp, Jr., Esq., as Trustee to administer the liquidation of GSC. This Court (per Hastings, J.) ordered the case removed to the

Bankruptcy Court for the Southern District of Florida (Cristol, J.).

On June 2, 1987, the Trustee provided written notice to NUFIC of a possible loss under the bond. Thereafter, on July 1, 1987, the Trustee brought an adversary proceeding against two employees of GSC, alleging theft of funds entrusted to them by customers of GSC. The Trustee advised NUFIC of this suit and sought information as to the proper manner of filing a loss claim under the bond.

In the normal course of business, NUFIC provides a form for its insureds to complete as part of filing a proof of loss. Despite repeated requests by the Trustee, NUFIC failed to provide such forms. NUFIC remained silent until December 23, 1987, when it informed the Trustee that coverage was denied by virtue of Section 12(c), the automatic termination clause set forth in the bond, which reads in pertinent part:

> This bond shall be deemed terminated or cancelled as an entirety:
>
> (c) immediately upon the taking over of the insured by a receiver or other liquidator or by State or Federal officials.

As a result of NUFIC's denial of coverage, the Trustee initiated this adversary proceeding, seeking a declaration of the parties' rights under the bond in light of 11 U.S.C. Section 541 (c)(1)(B), which invalidates automatic termination provisions.

NUFIC argued that Section 541 of the Bankruptcy Code is inapplicable to SIPA liquidation proceedings based upon the plain language of that section. NUFIC

maintained that this language limits application of that section to cases arising under Title 11 (i.e. straight bankruptcy cases). In addition, NUFIC argued that the fidelity bond in question was an executory contract, and therefore subject to 11 U.S.C. Section 365(d)(1), which requires a trustee to assume or reject executory contracts within 60 days of the filing of a petition for relief in bankruptcy. NUFIC maintains that because the Trustee failed to assume the so-called executory contract by July 13, 1987 (60 days after the filing of the petition for relief), it was deemed rejected, relieving NUFIC of any liability under the bond.

On November 15, 1988, the bankruptcy court held that the adversary action was a "core proceeding" and that "[r]elevant portions of the Bankruptcy Code which prevent an automatic termination or limitation of the estate's property rights upon the filing of a bankruptcy proceeding or appointment of a trustee are applicable in this adversary matter filed in a SIPA proceeding." *In re Government Sec. Corp.*, No. 87-0245-BKC-AJC-A (Bankr. S.D. Fla. Nov. 15, 1988) (Order on National Union's: Motion for Stay of Proceedings; Motion to Dismiss Amended Complaint; Motion for Determination of Nature of Proceedings; and Motion to Abstain). On March 15, 1989, the bankruptcy court issued its findings of fact and conclusions of law. The court determined that: a) Section 541(c)(1)(B) of the Bankruptcy Code was applicable to SIPA liquidation proceedings by virtue of 15 U.S.C. Section 78 fff-1(a) which provides that "a trustee shall be vested with the same powers and title with respect to the debtor and the property of the debtor as a

trustee in a case under Title 11;" b) an automatic termination provision of the fidelity bond NUFIC issued to GSC was void and unenforceable against the Trustee by virtue of 11 U.S.C. Section 541(c)(1)(B); c) the bond was not an executory contract for purposes of 11 U.S.C. Section 365(d)(1), and therefore, the Trustee was not obligated to assume the contract by July 13, 1987, the date upon which an executory contract must have been assumed by the Trustee in order to avoid being deemed rejected pursuant to 11 U.S.C. Section 365(d)(1); and d) even if the bond were executory on May 12, 1987 (the date which the petition for relief was filed), it ceased to be executory by July 13, 1987. Thereafter, the bankruptcy court issued its final judgment from which Appellant NUFIC appeals the following holdings: a) that the adversary proceeding was a "core" matter giving the bankruptcy court jurisdiction to hear and determine the proceeding pursuant to 28 U.S.C. Section 157(b)(1); b) that 11 U.S.C. Section 541(c)(1)(B) applies to SIPA liquidation proceedings, thereby invalidating the automatic termination provision contained in Section 12(c) of the bond issued by NUFIC to GSC; and c) that the bond was not an executory contract which the Trustee was required to assume or reject within sixty days.

DISCUSSION

Nature of Proceeding

First, this Court finds that NUFIC's position that the instant action was a "non-core" proceeding to be without merit. Core proceedings are those matters which "arise under Title 11" or that "arise in a case under Title 11." 28

U.S.C. Section 157 (b)(1). Moreover, 28 U.S.C. Section 157 (b)(2)(0) states that core proceedings include, but are not limited to, "other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship. . . . "

Non-core related proceedings are those matters that are traditional state law actions, not made subject to a federal rule or decision, but that are related, though only peripherally, to a pending bankruptcy case. Related matters are those non-core proceedings "that in the absence of . . . bankruptcy, could have been brought in a district court or a state court." *In re Colorado Energy Supply*, 728 F.2d 1283, 1286 (10th Cir. 1984).

11 U.S.C. Section 541 (c)(1)(B) creates substantive rights unknown at state law. Although GSC's right to recovery was pursuant to the bond, a legal right created under state law, the Trustee's ability to preserve rights under the bond exists solely under the Bankruptcy Code. Indeed, operation of Section 12(c) of the bond, the automatic termination provision, would not be an issue but for the existence of the Bankruptcy Code provision which precludes the operation of such clauses upon "insolvency, financial condition of debtor or on the commencement of a case under this title." 11 U.S.C. Section 541(c)(1)(B). As the Trustee correctly argues, this is not simply a state law contract action which, had there been no bankruptcy, could have proceeded in a state court. *In re Wood*, 825 F.2d 90, 97 (5th Cir. 1987).

Application of Section 541(c)(1)(B) could not be contemplated outside of bankruptcy, and the controversy involving payment on the bond affects the liquidation of

debtor's assets. Accordingly, this matter comes within the ambit of "core" proceedings, giving the bankruptcy court subject matter jurisdiction to hear and determine the instant case.

Application of 11 U.S.C. Section 541(c)(1)(B) to SIPA Liquidation Proceedings

Secondly, this Court finds that 11 U.S.C. Section 541(c)(1)(B) applies to SIPA liquidation proceedings, thereby invalidating Section 12(c), the automatic termination clause of the bond NUFIC issued to GSC.

The stated purposes of a SIPA liquidation proceedings are:

> (1)(B) To distribute customer property and otherwise satisfy net equity claims of customers to the extent provided in this section.
>
> * * *
>
> (4) To liquidate the business of the debtor.

15 U.S.C. Section 78fff(a).

15 U.S.C. Section 78 fff(b) provides:

> To the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, chapters 1, 3 and 5, and subchapters I and II of Chapter 7 of Title 11. . . .

Under 11 U.S.C. Section 541 (c)(1)(B):

> . . . an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section, notwithstanding any provision-
>
> B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

This Court finds that the application of 11 U.S.C. Section 541(c)(1)(B) is consistent with the purposes of SIPA as delineated in Section 78 fff(a)(1)(B). A bankruptcy provision is "inconsistent" with SIPA if it conflicts with an explicit provision of the Act, or if application would substantially impede fair and effective operation of the Act without providing significant countervailing benefits. *SIPC v. Charisma Sec. Corp.*, 506 F.2d 1191 (2d Cir. 1974). However, a bankruptcy provision does not become "inconsistent" simply because it is not absolutely necessary for the operation of the Act. *Id.*

Application of Section 541(c)(1)(B) invalidates the automatic termination clause of the bond, thereby leaving coverage of the debtor intact. Since the purpose of the bond is to insure the debtor against dishonest acts, as occurred in the instant case, it is difficult to imagine how application of Section 541(c)(1)(B) could be deemed anything but consistent with SIPA, the purpose of which is to protect customers of securities brokerages.

NUFIC contends that Section 541(c)(1)(B) only applies to cases arising under Title 11. NUFIC cites the plain language of the statute which reads:

> " . . . on the commencement of a case under this title or on the appointment of or taking possession by a trustee in a case under this title or a custodian. . . . "

Given that the instant case arose under Title 15, NUFIC argues that Section 541 is inapplicable.

The plain language of the Bankruptcy Code indicates that while an application for liquidation is filed pursuant to Title 15 U.S.C. Section 78eee(a)(3), the liquidation process commences under Title 11 U.S.C. Section 362 of the Bankruptcy Code states in pertinent part:

> " . . . an application filed under section 5(a)(3) of SIPA operates as a stay, applicable to all entities, of – (1) the commencement or continuation . . . of process . . . or other action or proceeding . . . that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title."

Accordingly, this Court holds that Section 541(c)(1)(B) is applicable in the instant case, thereby invalidating the automatic termination provision of the bond.

Executory Contracts

11 U.S.C. Section 365(a) provides that a trustee may assume or reject any executory contract or unexpired lease of the debtor. Pursuant to Section 365(d)(1), a

trustee has sixty days after the filing of the petition for relief within which to assume or reject an executory contract. Any contract not assumed during that period is automatically deemed rejected.

The Bankruptcy Code does not define an executory contract. However, the legislative history of Section 365 states that an executory contract is one in which performance remains due to some extent on both sides. H.R. Rep. No. 595, 95th Cong., 1st Sess. 347, *reprinted in* 1978 *U.S. Code Cong. & Admin. News*, 5787, 5844. Courts have frequently held that an executory contract is one in which:

> [T]he obligations of both the bankrupt and the other party to the contract are "so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other."

Countryman, *Executory Contracts in Bankruptcy*, Part 1, 57 Minn. L. Rev. 439, 460 (1973), *cited in In re Arrow Air. Inc.*, 60 Bankr. R. 117, 120 (Bankr. S.D. Fla. 1986); *In re Charter Co.*, 52 Bankr. R. 267, 270 (Bankr. M.D. Fla. 1985).

Other courts have adopted the so-called "Functional" approach in determining whether a contract is executory. Under this approach, a court considers the purpose behind allowing the debtor or trustee to assume or reject a contract. As the court stated in *In re G-N Partners*, 48 Bankr. R. 462, 465 (Bankr. Minn. 1985), "the purpose of the provision allowing a trustee to assume or reject any executory contract or unexpired lease is to allow a trustee to pick and choose among the debtor's agreements and assume those which benefit the estate. . . . " Likewise in

In re Norquist, 43 Bankr. R. 224, 225 (Bankr. Wash. 1984), the court stated that "[r]ejection of an executory contract serves two purposes. It relieves the debtor of burdensome future obligations . . . and it constitutes a breach of contract which permits the other party to file a creditor's claim."

The bankruptcy court determined that under either the "Countryman" approach (significant performance due on both sides) or the "Functional" approach (benefit of assumption or rejection to the estate), the bond was not an executory contract. As such, the Trustee was not required to assume or reject the Bond within 60 days of filing the petition for relief. This Court finds that the bankruptcy court correctly analyzed the nature of the fidelity bond at issue in determining that it was not an executory contract.

Under the first approach, the so-called "Countryman" approach, the bond was not an executory contract because the obligations of both parties were not so far unperformed that failure of either to complete performance would constitute a material breach. There were no obligations under the bond on GSC's part for which failure to perform would constitute a material breach giving rise to a claim by NUFIC against GSC.

Under Florida law, fidelity bonds are considered to be insurance contracts, and insurance contracts have been held to be executory. *In re Evans Prods. Co.*, 91 Bankr. R. 1003 (S.D. Fla. 1988). However, the sole basis for determining that an insurance contract is executory has been the fact that the bankrupt had a continuing obligation to make premium payments under the contract. *In re Evans*,

91 Bankr. R. at 1006; *In re Pester Refining Co.*, 58 Bankr. R. 189, 191 (Bankr. S.D. Iowa 1985); *In re B. Siegel Co.*, 51 Bankr. R. 159, 161 (Bankr. E.D. Mich. 1985).

The facts of those cases differ from the instant case in one crucial respect. In the present case, the debtor paid the premium in full prior to issuance of the bond. The only remaining duties to be performed by GSC were duties necessary to initiate the filing of a claim of loss under the bond. GSC's failure to do so could not constitute a material breach giving rise to a claim by NUFIC against the estate. Rather, GSC's failure to perform those duties necessary to the filing of a claim could only benefit NUFIC, which would avoid liability to which it would otherwise be subject. Therefore, using the "Countryman" approach, the bond was not an executory contract.

Applying the second approach, the so-called "Functional" approach, the bond was not an executory contract. Under this approach, whether a contract is executory is determined by the benefits that assumption or rejection would produce for the estate. *In re Norquist*, 43 Bankr. R. at 225. Using the "Functional" approach, the bond in the instant case is clearly not executory, since rejection could not have possibly benefitted the estate. In fact, if the Court were to find that the bond was an executory contract, and thus deemed rejected by the Trustee's failure to assume, the only party to benefit from this determination would be NUFIC, which would be relieved from liability under the bond. As the bankruptcy court correctly noted, GSC, as the insured, would have given up valuable, bargained-for protection against losses. Because a finding that the bond was executory would be detrimental to

customers of GSC, such a finding would be clearly inconsistent with the stated purposes of SIPA.

Based on the above and foregoing, it is hereby

ORDERED AND ADJUDGED that the FINAL JUDGMENT of the bankruptcy court is AFFIRMED,

Done and ordered in Chambers at Miami, Florida, this 16 day of March, 1990.

/s/ Eugene P. Spellman
EUGENE P. SPELLMAN
UNITED STATES DISTRICT JUDGE

cc: all counsel of record

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

(S.I.P.A. Proceeding)

Case No. 87-0910-C-KEHOE
87-0245-BKC-AJC-A

In Re:	)	
GOVERNMENT SECURITIES CORPORATION,	)	
Debtor.	)	
JOHN R. CAMP, JR., TRUSTEE,	)	
Plaintiff,	)	
v.	)	
NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,	)	ADV. NO. 88-0427-BKC-AJC-A
Defendant.	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On February 1, 1989, the Court conducted a trial without a jury in the captioned proceeding. The Court has considered all of the evidence presented, facts admitted in the pleadings, and the argument of counsel. In accordance with Rule 7052 of the Bankruptcy Rules and Rule 52 of the Federal Rules of Civil Procedure, the Court

makes the following findings of fact, conclusions of law, and Order for Judgment.[1]

FINDINGS OF FACT

1. National Union Fire Insurance Company of Pittsburgh, PA., New York, New York (hereafter "NUFIC") issued a Securities Dealer Blanket Bond to Government Securities Corporation (hereafter "GSC"), which became effective on February 1, 1987 and was scheduled to expire on November 1, 1987. Amended Complaint ¶ 5; NUFIC Answer ¶ 3. The premium for the bond period, i.e., February 1, 1987 through November 1, 1987 had been paid prior to the issuance of the bond. Trial Tr. at 31, 58.

2. On May 12, 1987, the Honorable Alcee L. Hastings, as the Duty Judge, entered an order commencing the liquidation of GSC under the Securities Investor Protection Act of 1970 as amended (S.I.P.A.), 15 U.S.C. §§ 78 aaa *et seq.* in Case No. 87-910-CIV-KEHOE (S.D. Fla.). Amended Complaint ¶ 3; NUFIC Answer ¶ 3.

3. Under the terms of Judge Hastings' Order, John R. Camp, Jr. was appointed Trustee for the liquidation of GSC and the liquidation proceeding was removed to this Court. *Id;* Trial Tr. at 36.

4. By letter dated June 2, 1987, the Trustee acting on behalf of GSC, the insured, put NUFIC on notice of a possible loss under the bond. Trial Tr. at 37, 39-40, 44, 56;

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[1] Any finding of fact incorrectly denominated as a conclusion of law shall be deemed a finding of fact; any conclusion of law incorrectly denominated as a finding of fact shall be deemed a conclusion of law.

Plaintiff's Ex. 1. The Trustee's letter, which describes and attaches a copy of Judge Hastings' Order of May 12, 1987, states in part:

> In the course of our review of the files of GSC, we have determined that your firm issued a Securities Dealer Blanket Bond, which became effective on February 1, 1987. This letter is sent in accordance with the terms of Section 4 of the Bond, and is designed to serve as notice of a possible loss covered by that bond.

Plaintiff's Exhibit 1. The Trustee further advised NUFIC that his investigation would continue and he desired the maximum period of time under the bond for submission of affirmative proof of loss. *Id.* In so doing, the Trustee clearly manifested his intent to seek all available coverage afforded by the bond.

5. In response to the Trustee's letter, counsel for NUFIC advised the Trustee that it had been retained and further communications should be directed to counsel. Trial Tr. at 37-38.

6. Counsel for NUFIC thereafter conducted an investigation on behalf of NUFIC into the possible loss, and NUFIC's investigation was substantially completed on or about July 2, 1987. Trial Tr. at 30, 60.

7. In the normal course of business, NUFIC provides a form to the insured to complete as a part of the filing of a proof of loss with NUFIC. Trial Tr. at 66. Notwithstanding repeated efforts to obtain NUFIC's assistance in the filing of the proof of loss and to determine NUFIC's procedures for filing the proof of loss,

NUFIC did not provide the forms to the Trustee or his counsel. Trial Tr. at 66-67.

8. Notwithstanding the Trustee's actions, NUFIC has refused to provide coverage under the bond claiming that the bond was terminated upon appointment of the Trustee on May 12, 1987, by virtue of Section 12 (c) of the bond, the so-called automatic termination provision. Amended Complaint ¶ 7; NUFIC Answer ¶ 3; NUFIC Affirmative Defense ¶ 4. This section of the bond provides:

> Section 12. This bond shall be deemed terminated or canceled as an entirety:
>
> * * *
>
> (c) immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials,. . . .

Id. The Securities Dealer Blanket Bond issued by NUFIC to GSC provides coverage, *inter alia*, for "loss sustained by the Insured at any time but discovered during the Bond Period. . . . " Amended Complaint, Exhibit A (opening paragraph). NUFIC takes the position that the bond terminated under Section 12 (c) of the bond upon appointment of the Trustee. Thus, NUFIC argues any discovery occurred after the bond period ceased and no coverage existed.

9. Section 12 of the bond also provides, in relevant part, that:

> This bond shall be deemed terminated or cancelled as to any Employee: (a) as soon as the Insured shall learn of any dishonest or fraudulent act on the part of such Employee. . . .

10. Under the terms of the bond, NUFIC has an obligation to pay claims made under a bond within 48 hours of a decision that the claim is clear and undisputed. Trial Tr. at 27-28. The presence of the automatic termination provision, i.e., Section 12 (c) of the bond, constitutes the principal basis for NUFIC's claim that the Trustee's claim is not clear and undisputed. *Id.* at 64.

11. By virtue of NUFIC's position on Section 12 (c) of the bond, the Trustee filed this adversary proceeding. The Trustee relies on Section 541 (c) (1) (B) of the Code, the so called *anti-ipso facto* provision, arguing:

> The basis for the declaratory relief sought by the trustee is simple. The bond and the trustee's rights under it are property of the estate, [f/n omitted] and § 541 (c) (1) (b) of the Bankruptcy Code specifically invalidates bankruptcy termination provisions which impair the trustee's property rights. [f/n omitted].

Plaintiff's Response to Defendant's Motion for Stay of Proceedings, Motion for Determination of Nature of Proceedings, Motion to Dismiss and Motion to Abstain at 14. *See also* Trial Tr. at 5.

12. In response to the Amended Complaint, NUFIC contends: a) the bond constitutes an executory contract within the meaning of Section 365 of the Bankruptcy Code; b) the Trustee did not assume the contract; c) the contract, therefore, was rejected and deemed breached under Section 365 (g) prior to the entry of Judge Hastings' Order of May 12, 1987; and d) no bond, therefore, existed after May 12, 1987 to afford coverage for a discovery made in June, 1987.

13. The validity of Section 12 (c) of the Bond must be assessed under Section 541 (c) (1) (B) if the Trustee's position is adopted. Moreover, even if Section 365, pertaining to executory contracts, is applicable, Section 12 (c) of the Bond must be considered under Section 365 (e) (1) of the Code. As stated by this Court previously, under both provisions, Section 12 (c) must fall. *See* Trial Tr. at 3-4, 71.

14. In support of its position that the contract was executory as of Monday, July 13, 1987, NUFIC offered the testimony of John J. Morrissey, bond claims counsel for NUFIC and its parent American International Group. Trial Tr. at 23-24, 47.

15. Mr. Morrissey is an attorney admitted to practice in New York. He is not admitted to practice in Florida, whose law controls the rights and obligations of the parties to the bond, except to the extent bankruptcy law applies. Mr. Morrissey is not and does not claim to be an expert on Florida law and its applicability to the bond issued by NUFIC. Mr. Morrissey testified solely on the industry's analysis of the duties imposed by the bond on NUFIC and the insured.

16. Mr. Morrissey testified that the industry and NUFIC view the bond as imposing four principal duties – two on the insured and two on the insurer. The insured must notify NUFIC of claims and advise NUFIC if the insured acquires another entity or is acquired by another entity. The insurer (NUFIC) has an obligation to investigate and to pay on a claim or deny the claim and explain the basis for the denial. Trial Tr. at 24-25, 30, 52, 54, 55. Technical requirements under the bond, which have a less

important role, include the duty by the insured to cooperate, to file proof of loss, and avoid prejudicing NUFIC's subrogation rights. Trial Tr. at 52-53, 59. Finally, the premium must be paid. *Id.* at 52, 58.

17. Mr. Morrissey admits and the Court finds that the premium was paid prior to the effective date of the bond, i.e., on or before February 1, 1987. Trial Tr. at 31, 58. By virtue of the May 12, 1987 Order placing GSC in liquidation, no obligation existed to advise NUFIC of an acquisition at that point. Trial Tr. at 25, 56. The Trustee's letter of June 2, 1987 (Plaintiff's Ex. 1), which was received shortly thereafter, satisfied the obligation to notify NUFIC of a possible loss. Trial Tr. at 56-57. The Trustee also satisfied any obligation to cooperate with NUFIC by July 2, 1987. Trial Tr. at 31, 69. Mr. Morrissey admits that the Trustee had satisfied all of his principal duties, including providing notice of a possible loss to NUFIC, and even some technical requirements of the bond by July 2, 1987. Trial Tr. at 27, 57-58.

18. In direct response to the Trustee's letter of June 2, 1987, and with the understanding that the Trustee sought to invoke the coverage of the bond, NUFIC initiated an investigation of the claim which was substantially completed by July 2, 1987.

19. By July 2, 1987, therefore, all of the principal obligations of the Trustee had been satisfied and the only obligation remaining for NUFIC was payment or denial of the claim.

20. The Order placing GSC in liquidation was entered on May 12, 1987. The Trustee did not file a motion to assume the bond under Section 365 of the

Code, if it were an executory contract, prior to Monday July 13, 1987. For the reasons set forth in the findings of fact made above, and the conclusions of law reached below, the bond was not an executory contract on May 12, 1987, and even if it were executory on that date, it ceased to be executory by July 13, 1987. Thus, there was nothing to be assumed or rejected.

CONCLUSIONS OF LAW

1. The trustee is entitled to the declaratory relief he seeks. It is beyond cavil that the Trustee's rights under the bond constitute and constituted property of the estate under Section 541 of the Code and the automatic termination provision contained in Section 12(c) of the bond is and was ineffective by virtue of Section 541(c)(1)(B) notwithstanding the commencement of the liquidation of GSC under S.I.P.A. and the appointment of Mr. Camp as Trustee. The rights, powers, and protection given to a bankruptcy trustee by the Code are adopted by reference into S.I.P.A., 15 U.S.C. Sections 78fff(b), 78fff-1(a). Fidelity bonds, like insurance policies, are among those property interests of the estate protected by the Code's anti-termination provision contained in Section 541(c)(1)(B). *See In re Gulf Tampa Drydock Co.*, 49 B.R. 154 (Bankr. M.D. Fla. 1985).

2. The statutory basis of NUFIC's contention that the Securities Dealer Blanket Bond was an executory contract is 11 U.S.C. Section 365, the Bankruptcy Code provision that deals with executory contracts and unexpired leases.

3. With exceptions not relevant here, section 365(a) provides that the trustee may assume or reject any executory contract or unexpired lease of the debtor. Pursuant to section 365(d)(1), the trustee has sixty days from the order for relief within which to assume or reject an executory contract. Any contract not assumed within that period is deemed rejected. Significantly, under section 365(g), the rejection of an executory contract by the debtor constitutes a breach of such contract and gives rise to a claim by the non-bankrupt party against the debtor's estate.

4. The Bankruptcy Code does not define an executory contract. The legislative history to section 365 states that though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides. H.R.Rep. No. 595, 95th Cong., 1st Sess. 347, repr. in 1978 U.S. Code Cong. & Admin. News 5787, 5844. In determining whether a contract is executory, the courts have frequently followed the definition of Professor Countryman who defined an executory contract as one: "under which the obligation of both the bankrupt and the other party to the contract are so far unperfected that the failure of either to complete the performance would constitute a material breach excusing the performance of the other." Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L. Rev. 439, 460 (1973) *quoted in In re Arrow Air, Inc.*, 60 B.R. 117, 120 (Bankr. S.D. Fla. 1986); *In re Charter Co.*, 52 B.R. 267, 270 (Bankr. M.D. Fla. 1985); *In re B. Siegel Co.*, 51 B.R. 159, 161 (Bankr. E.D. Mich. 1985).

5. By logical necessity the above-cited definition of executory contract must contemplate that the performance that remains due by the debtor is such that its failure to perform would be a breach of contract which would give rise to a claim by the non-bankrupt against the debtor's estate. *See, e.g., Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (Bankr. 4th Cir. 1985), *cert. denied*, 475 U.S. 1057, 106 S.Ct. 1285, 89 L.Ed.2d 592 (1986) (holding that technology licensing agreement was an executory contract where the debtor owed the non-bankrupt continuing duties, *inter alia*, to notify of patent infringement suits and other uses of or licensing of a certain process and the non-bankrupt owed the debtor reciprocal duties of accounting for and paying royalties for use of the process); *In re Sun City Investments*, 89 B.R. 245 (Bankr. M.D. Fla. 1988) (holding that contract requiring debtor to deliver certain vehicles and convey title to certain real property to non-debtor and requiring the non-debtor to obtain a substitute mortgage on certain real property was an executory-contract); *In re Arrow Air, Inc.*, 60 B.R. 117 (Bankr. S.D. Fla. 1986) (holding that contract that imposed upon bankrupt airline the obligation to use certain types of aircraft while operating at port authority airports and upon port authority the obligation to provide the airline with access to its airports and airport services was executory).

6. A second approach to defining executory contracts is the functional approach. *See In re Arrow Air*, 60 B.R. at 121. Under the functional approach, executory contracts are measured not by mutuality of commitments but by the nature of the parties and the goals of reorganization. *See In Re Arrow Air*, 60 B.R. at 122, *citing In re*

Booth, 19 B.R. 53, 56 (Bankr. D. Utah 1982). Thus, under the functional approach, the court considers the purpose behind allowing the debtor or trustee to assume or reject a contract in determining whether or not it is executory. *Id.*[2]

7. Whether this Court adopts the Countryman definition of executory contracts or applies the functional approach to defining executory contracts in this case, it is clear that the Securities Dealer Blanket Bond issued by NUFIC to GSC was not an executory contract within the contemplation of the Bankruptcy Code.

8. The bond was not an executory contract under the Countryman definition because there were no obligations under the blanket bond on GSC's part such that its failure to perform would have been a material breach of the contract excusing NUFIC's performance and giving rise to a claim by NUFIC against the estate. It is recognized that, under Florida law, a fidelity bond is considered an insurance contract and that, in the bankruptcy context, insurance contracts are *generally* considered executory contracts. *See In re Pester Refining Co.,* 58 B.R. 189 (Bankr. S.D. Iowa 1985); *In re B. Siegel Co.,* 51 B.R. 159 (Bankr. E.D. Mich. 1985). Significantly, however, the sole basis for the holding that a contract for insurance is an

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[2] The functional approach to defining executory contracts is not entirely separate and distinct from the above-cited Countryman definition and is, in fact, actually suggested by Professor Countryman. Professor Countryman suggested that executory contracts should be defined in light of the purpose for which the trustee is given the power to assume or reject, which is to benefit the estate. Countryman, *Executory Contracts in Bankruptcy,* 57 Minn. L. Rev. 439, 450 (1973).

executory contract has been the fact that the bankrupt insured had a continuing obligation to make premium payments under the contract. *See, e.g., Pester,* 58 B.R. at 191; *B. Siegel,* 51 B.R. at 161. The holding of the cited authorities is inapplicable here because, prior to the bankruptcy, GSC made full payment and NUFIC issued the bond. Thus, the coverage that was the object of the contract had been completely obtained by GSC prior to the bankruptcy. *See In Re Placid Oil Co.,* 72 B.R. 135 (Bankr. N.D. Tex. 1987).[3]

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[3] NUFIC's reliance on *In re Evans Products Co.,* 91 B.R. 1003 (Bankr. S.D. Fla. 1988) in support of its argument that the bond in this case was an executory contract is misplaced for two reasons. First, the policy underlying the court's holding that the surety bond in *Evans* was an executory contract does not apply here. In *Evans,* the debtor needed the coverage afforded by the surety bond in order to continue its operation, operated for a period of time by virtue of the benefit it received, and then sought to avoid paying the premium for the bond. The court's holding in *Evans* in essence indicated that it would be inequitable to allow a debtor to receive the benefits of a contract without performing its duty of payment. That reasoning is not applicable in this case because, as set forth herein, GSC had made full payment for its coverage prior to bankruptcy and, therefore, does not seek to avoid any duty of payment. In fact, it is NUFIC that seeks to avoid its duty of payment for GSC's losses under the bond.

Second, there are significant differences between a surety bond, such as the one in *Evans,* and the fidelity bond issued by NUFIC which make *Evans* inapplicable here. A fidelity bond provides coverage for the insured against losses suffered by the insured as the result of the infidelity of its employees. Under a fidelity bond, the insured's primary duty is payment of the premiums. A surety bond, on the other hand, provides coverage to third parties against losses they suffer as a result of the principal's conduct. The surety's payment for losses sustained

9. The only remaining duties on GSC's part, which the Trustee satisfied, were to notify NUFIC of claims under the contract and to notify NUFIC if it acquired or was acquired by another entity. The former duty is a condition precedent to NUFIC's payment for GSC's losses. *See Bankers Ins. Co. v. Macias*, 475 So.2d 1216, 1218 (Fla. 1985); *Independent Fire Ins. Co. v. NCNB Nat'l Bank*, 517 So.2d 59, 64 (Fla. 1st DCA 1987). The latter, to the extent that it can be construed as requiring notice of an increase in hazard, is a condition subsequent to the contract. *See Independent Fire Ins.*, 517 So.2d at 64. Thus, GSC's failure to comply could not have been a material breach giving rise to a claim by NUFIC against the estate.

10. Under the functional approach to defining executory contracts it is clear that the blanket bond issued by NUFIC was not an executory contract.

11. In applying the functional approach, it is necessary to work backward, proceeding from an examination of the goals rejection is expected to accomplish. *See In re Jolly*, 574 F.2d 349, 351 (Bankr. 6th Cir.), *cert. denied*, 439 U.S. 929, 99 S.Ct. 316, 58 L.Ed.2d 322 (1978). If those purposes have already been accomplished or if they cannot be accomplished through rejection, then the contract

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by third parties creates obligation on the part of the principal to reimburse the surety for its payment. Thus, *Evans* is analogous to the cited insurance cases where the courts have held that the insured's continuing obligation to make premium payments renders the contract executory. Those authorities establish that where, as here, the insured had no obligation to make any payments, the contract is not executory.

is not executory within the meaning of the Bankruptcy Code. *Id.*

12. The purpose underlying the provision allowing the trustee or the debtor to assume or reject a contract is to benefit the estate by providing a mechanism through which severe financial burdens may be lifted. *See In re Herbert*, 806 F.2d 889, 893 (9th Cir. 1986) *citing* 2 *Collier on Bankruptcy* ¶ 365.01 (15th ed. 1986); *In Re Central Florida Fuels, Inc.*, 89 B.R. 242, 244 (Bankr. M.D. Fla. 1988); *In re Arrow Air*, 60 B.R. at 122. This purpose could not possibly have been accomplished through rejection of the contract in this case. In fact, if the contract had been rejected, precisely the opposite would have happened. GSC, as the insured, would have given up valuable, bargained-for protection against losses. The only possible benefit to be derived from GSC's rejection of the contract would have been to NUFIC. If the Court determined that the contract was an executory contract, NUFIC would be relieved of all liability on a blanket bond for which it received full payment prior to the bankruptcy. In asserting that the contract was executory, NUFIC, the non-bankrupt, is attempting to utilize to its advantage a statute designed to inure to the benefit of the bankrupt or the bankruptcy estate. In effect, NUFIC is asking the Court to use the trustee's avoidance power against the trustee. Such a result in this context is not contemplated by the Bankruptcy Code. *See In re A. H. Robins Co., Inc.*, 68 B.R. 705, 707 (Bankr. E.D. Va. 1986).

13. Accordingly, this Court concludes that the Securities Dealer Blanket Bond issued by NUFIC to GSC is not an executory contract that was capable of being assumed or rejected by the trustee. The trustee's failure to assume

the contract within the period prescribed by the Code will, therefore, not be deemed a rejection of the contract that relieves NUFIC of its obligation to provide coverage for the possible loss reported by the trustee on June 2, 1987.

14. Even if this Court were to determine that the bond was an executory contract at the time of the commencement of the bankruptcy proceedings, NUFIC would not be relieved of its obligation to provide coverage for the possible loss reported on June 2, 1987.

15. The critical date for determining the executory nature of a contract is the date on which the bankruptcy court considers the debtor's application to assume or reject the contract. *In re Pesce Baking Co., Inc.*, 43 B.R. 949, 957 (Bankr. N.D. Ohio 1984), *citing Gloria Mfg. v. International Ladies Garment Workers*, 734 F.2d 1020 (4th Cir. 1984), *In re Total Transp. Serv., Inc.*, 37 B.R. 904, 11 B.C.D. 872 (Bankr. S.C. Ohio 1984). Although a contract may be executory on the date the bankruptcy petition is filed, *see In re Pesce*, 43 B.R. at 457, circumstances may arise which render the contract no longer executory. For example, if the agreement expires of its own terms before the bankruptcy court considers the application to assume or reject the contract, the application becomes moot as there is no longer anything to assume or reject. *Id.*

16. Thus, if the bond in this case were executory at the time of the commencement of the bankruptcy proceedings, but expired of its own terms (i.e., the expiration/renewal date was reached) a few days later, there would have been nothing for the trustee to assume or reject on the sixtieth day and any motion for assumption

or rejection would have been deemed moot. The same analysis is true in the instant case.

17. In this case, the bond specifically provided that it shall be deemed terminated or cancelled as to any employee as soon as the insured shall learn of any dishonest or fraudulent act on the part of such employee.[4] The trustee reported the possible loss in June, 1987. As of the date of discovery, the bond, by its own terms, was terminated or cancelled as to those employees. Thus, on the sixtieth day, i.e., July 13, 1987, any application to assume the contract would have been deemed moot as to coverage for the employees whose acts gave rise to the loss under the bond.

18. To the extent Section 365 had some applicability, Section 12(c) of the bond is and was ineffective under Section 365(e)(1) notwithstanding the commencement of the liquidation of GSC under S.I.P.A. and the appointment of Mr. Camp as Trustee. Insurance policies are among those property interests of the estate protected by the Code's anti-termination provision. *See e.g., In re Garnar,* 31 B.R. 221 (Bankr. D. N.D. 1984). The rights and powers accorded to the trustee by the Code are adopted by reference into S.I.P.A., 15 U.S.C. §§ 78fff(b), 78fff-1(a).

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[4] This automatic termination provision, unlike the provision in Section 12(c) of the bond, remained unaffected by Section 541(c)(1)(B) or 365(e)(1) because it was not conditioned on insolvency of the debtor, commencement of the liquidation, or the appointment of a Trustee.

Thus, the trustee in this case is entitled to the protection afforded by Section 365(e)(1) of the Code.[5]

19. Judgment shall be entered accordingly.

Dated: at Miami, Florida this 15 day of March, 1989.

A. JAY CRISTOL
A. JAY CRISTOL
Bankruptcy Judge

Copies to:

Carl K. Hoffman, Esq.
Kimbrell & Hamann, P.A.
Suite 900, Brickell Center
799 Brickell Plaza
Miami, Florida 33131
Counsel for Defendant

Neal B. Shniderman
Blackwell, Walker, Fascell
& Hoehl
2400 AmeriFirst Building
One Southeast Third Avenue
Miami, Florida 33131
Counsel for Plaintiff

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[5] By virtue of the foregoing findings of fact and conclusions of law, Plaintiff's Motion for Judgment on the Pleadings is rendered moot.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

(S.I.P.A. Proceeding)

Case No. 87-0910-C-KEHOE
87-0245-BKC-
AJC-A

In Re: GOVERNMENT SECURITIES CORPORATION, Debtor.	ADV. NO. 88-0427-BKC-AJC-A
JOHN R. CAMP, JR., TRUSTEE, Plaintiff, v. NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., Defendant.	

FINAL JUDGMENT

This action came on for trial on February 1, 1989 before the Court, Honorable A. Jay Cristol, Bankruptcy Judge, presiding. The issues having been duly tried and a decision and findings of fact and conclusions of law having been duly rendered,

It is Ordered, Adjudged, and Decreed that:

1. The plaintiff, John R. Camp, Jr., Trustee is entitled to a declaration of his rights under the Securities Dealer

Blanket Bond ("the bond") issued by the National Union Fire Insurance Company of Pittsburgh, PA to Government Securities Corporation;

2. Section 12(c) of the bond provides:

> This bond shall be deemed terminated or cancelled as an entirety immediately upon the taking over of the insured by a receiver or other liquidation by state or federal officials;

3. The Trustee in this case is entitled to the protection afforded by Title 11 of the United States Code against the termination clause, i.e., Section 12(c) of the bond. 15 U.S.C. §§ 78fff(b); 78fff-1(a);

4. Section 12(c) of the bond is void and unenforceable against the Trustee by virtue of 11 U.S.C. § 541(c)(1)(B);

5. The bond was not an executory contract within the meaning of 11 U.S.C. § 365 as of May 12, 1987, but even if it were, the contract ceased to be executory prior to July 13, 1987. Similarly Section 12(c) of the bond is void and unenforceable against the Trustee under 11 U.S.C. § 365(e)(1).

Done and Ordered at Miami, Florida on this 15th day of March, 1989.

A. JAY CHISTOL
A. JAY CRISTOL
Bankruptcy Judge

Copies to:

Carl K. Hoffman, Esq.
Kimbrell & Hamann, P.A.
Suite 900, Brickell Center
799 Brickell Plaza
Miami, FL 33131
Counsel for Defendant

Neal B. Shniderman, Esq.
Blackwell, Walker, Pascell & Hoehl
#2400 AmeriFirst Building
One S.E. Third Avenue
Miami, FL 33131
Counsel for Plaintiff

¶2181 Securities "Failed to Receive" and "Failed to Deliver"

¶2181A APPENDIX B

(a) No member, or person associated with a member, shall sell a security for his own account, or buy a security as a broker for a customer (except exempt securities), if,

(1) in respect to domestic securities, he has a fail to deliver in that security 60 days old or older; or

(2) in respect to foreign securities, he has a fail to deliver in that security 90 days old or older (except American Depositary Receipt and Canadian securities, which shall be subject to the provisions of paragraph (1)).

(b) For good cause shown and in exceptional circumstances, a member may request exemption from the provisions of this rule by written request to the District Director of the District in which his principal office is located.

[Sec. 31 added effective September 24, 1973.]

¶ 2182 Fidelity Bonds

Sec. 32.

Application

(a) Every member shall be required to carry a blanket fidelity bond meeting requirements as to form, amount and type of coverage as the Board of Governors may prescribe pursuant to the authorization granted by paragraph (b) hereof.

Authority of Board

(b) The Board of Governors is hereby authorized to adopt rules, regulations and procedures for blanket fidelity bonds concerning the form, amount and type of coverage thereof. The rules, regulations and procedures authorized hereby shall be incorporated into Appendix C to be attached to and made part of this rule. The Board of Governors shall have the power to alter, amend, supplement or modify the provisions of Appendix C from time to time without recourse to the membership for approval, as would otherwise be required by Article VII of the By-Laws. All contemplated changes shall, however, be submitted to the membership for comment prior to effectiveness. Appendix C shall become effective as the Board of Governors may prescribe unless disapproved by the Securities and Exchange Commission.

¶ 2182A **APPENDIX C**

Coverage Required

(a) Each member required to join the Securities Investor Protection Corporation who has employees and who is not a member in good standing of the American Stock Exchange, Inc., the Boston Stock Exchange, the Midwest Stock Exchange, Inc., the New York Stock Exchange, Inc., the Pacific Stock Exchange, Inc, the Philadelphia Stock Exchange, Inc., or the Chicago Board Options Exchange shall:

(1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America,

covering officers and employees which provides against loss and has agreements covering at least the following:

(a) Fidelity

(b) On Premises

(c) In Transit

(d) Misplacement

(e) Forgery and Alteration (including check forgery)

(f) Securities Loss (including securities forgery)

(g) Fraudulent Trading

(h) Cancellation Rider providing that the insurance carrier will use its best efforts to promptly notify the National Association of Securities Dealers, Inc. in the event the bond is cancelled, terminated or substantially modified.

(2) Maintain minimum coverage for all insuring agreements required in this subsection (a) of not less than $25,000;

(3) Maintain required minimum coverage for fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less than 120% of its required net capital under Rule 15c3-1 up to $600,000. Minimum coverage for required net capital in excess of $600,000 shall be determined by reference to the following table:

Net Capital Requirement under Rule 15c3-1	Minimum Coverage
$ 600,001– 1,000,000	750,000
1,000,001– 2,000,000	1,000,000
2,000,001– 3,000,000	1,500,000
3,000,001– 4,000,000	2,000,000
4,000,001– 6,000,000	3,000,000
6,000,001–12,000,000	4,000,000
12,000,001–and above	5,000,000

(4) Maintain Fraudulent Trading coverage of not less than $25,000 or 50% of the coverage required in subsection (a)(3), whichever is greater, up to $500,000;

(5) Maintain Securities Forgery coverage of not less than $25,000 or 25% of the coverage required in subsection (a)(3), whichever is greater, up to $250,000.

Deductible Provision

(b)(1) A deductible provision may be included in the bond of up to $5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.

(2) If a member desires to maintain coverage in excess of the minimum insurance requirement then a deductible provision may be included in the bond of up to $5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount described in paragraph (b)(1) above must be deducted from the member's net

worth in the calculation of the member's net capital for purposes of Rule 15c3-1 under the Securities Exchange Act of 1934. Where the member is a subsidiary of another NASD member the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Annual Review of Coverage

(c)(1) Each member, other than members covered by subsection (c)(2) herein, shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subsections (a)(2), (3), (4) and (5) herein.

(2) Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest aggregate indebtedness it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under Rule 15c3-1 in determining the minimum required coverage to be carried in the member's second year pursuant to subsections (a)(2), (3), (4) and (5) herein. Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than sixty days after the anniversary date of the issuance of such bond.

Notification of Change

(d) Each member shall report the cancellation, termination or substantial modification of the bond to the Association within ten business days of such occurrence.

Definitions

(e) For purposes of fidelity bonding the term "employee" or "employees" shall include any person or persons associated with a member firm (as defined in Article I, Section 3(m) of the By-Laws) except:

(1) Sole Proprietors

(2) Sole Stockholders

(3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.

[Section 32 added effective March 15, 1974; last amended effective July 11, 1979; November 19, 1982.]

§ 78iii. Functions Of Self-Regulatory Organizations

* * *

(c) INSPECTIONS. – The self-regulatory organization of which a member of SIPC is a member or in which it is a participant shall inspect or examine such member for compliance with applicable financial responsibility rules, except that –

> (1) if the self-regulatory organization is a registered clearing agency, the Commission may designate itself as responsible for the examination of such member for compliance with applicable financial responsibility rules; and
>
> (2) if a member of SIPC is a member of or participant in more than one self-regulatory organization, the Commission, pursuant to section 78q(d) of this title, shall designate one of such self-regulatory organizations or itself as responsible for the examination of such member for compliance with applicable financial responsibility rules.

(d) REPORTS. – There shall be filed with SIPC by the self-regulatory organizations such reports of inspections or examinations of the members of SIPC (or copies thereof) as may be designated by SIPC by bylaw or rule.

(e) CONSULTATION. – SIPC shall consult and cooperate with the self-regulatory organizations toward the end:

> (1) that there may be developed and carried into effect procedures reasonably designed to detect approaching financial difficulty upon the part of any member of SIPC;

(2) that, as nearly as may be practicable, examinations to ascertain whether members of SIPC are in compliance with applicable financial responsibility rules will be conducted by the self-regulatory organizations under appropriate standards (both as to method and scope) and reports of such examinations will, where appropriate, be standard in form; and

(3) that, as frequently as may be practicable under the circumstances, each member of SIPC will file financial information with, and be examined by, the self-regulatory organization which is the examining authority for such member.

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§ 78fff. General Provisions Of A Liquidation Proceeding

(a) PURPOSES. – The purposes of a liquidation proceeding under this chapter shall be –

(1) as promptly as possible after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this chapter –

(A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in section 78fff-2(c)(2) of this title; and

(B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section;

(2) to sell or transfer offices and other productive units of the business of the debtor;

(3) to enforce rights of subrogation as provided in this chapter; and

(4) to liquidate the business of the debtor.

(b) APPLICATION OF TITLE 11. – To the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of Title 11. For the purposes of applying such title in carrying out this section, a reference in such title to the date of the filing of the petition shall be deemed to be a reference to the filing date under this chapter.

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SUBCHAPTER III

The Estate

SECTION 541 (11 U.S.C. § 541)

§ 541. Property of the estate.

* * *

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law –

* * *

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

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